DOCUMENT RESUME

ED 146 856 HE 009 422

TITLE Report to the Congress of the Committee on Process of Determining Student Loan Special Allowances.
INSTITUTION Committee on the Process of Determining Student Loan Special Allowances, Washington, D.C.
PUB DATE Oct 77
NOTE 185 p.; Some charts and tables may not reproduce well

EDRS PRICE MF-$0.83 HC-$8.69 Plus Postage.
DESCRIPTORS *Cost Effectiveness; Cost Indexes; Educational Finance; *Federal Programs; Federal Regulation; Financial Policy; Higher Education; Post Secondary Education; *Program Costs; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS Education Amendments 1976; *Guaranteed Student Loan Program

ABSTRACT

The committee examined the special allowance made to lenders in the Guaranteed Student Loan Program to assure that it continues to be an effective incentive. The allowance was examined in its relation to: (1) administrative costs incurred by lenders, including those attributable to federal regulations; and (2) appropriate money-market indices. A cost audit of lenders was undertaken as part of the study. The results confirm in a detailed way the general concensus that the special allowance, as restructured by the Educational Amendments of 1976, is working to the benefit of the loan program and does provide lenders with a more accurate method of assessing current and prospective allowance payments. Among the committee's specific recommendations are that more consideration be given to relative administrative costs and money-market conditions in setting the allowance rate, and that an intensive cost-benefit analysis of proposed loan program regulations be undertaken before implementation of those regulations. (MSE)

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ED146856

# REPORT TO THE CONGRESS
# OF THE COMMITTEE ON PROCESS OF DETERMINING
# STUDENT LOAN SPECIAL ALLOWANCES

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HE009422

October 1, 1977

The President of the Senate
The Speaker of the House of Representatives

Sirs:

Pursuant to the provisions of Section 438(e) of the Higher Education Act of 1965, submitted herewith is the Report of the Committee on Process of Determining Student Loan Special Allowances. This Report contains the findings and recommendations of the Committee with respect to an improved method for determining the special allowance paid to eligible lenders under the Guaranteed Student Loan Program.

Very truly yours,

Edward A. Fox

Edward A. Fox, Chairman
Committee on the Process of
Determining Student Loan
Special Allowances

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### ACKNOWLEDGEMENT

The Committee wishes to thank Dennis A. Kernahan of the Student Loan Marketing Association who served as de facto staff to the Committee and is the primary author of this report.

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## OVERVIEW

In this report, the Committee on the Process of Determining Student Loan Special Allowances has examined the special allowance to assure that it continues to be an effective incentive to lenders participating in the Guaranteed Student Loan Program (GSLP). To this end, the allowance was analyzed in light of its relation to administrative costs incurred by lenders, including those attributable to Federal regulations, and with regard to appropriate money market indices.

As part of the study, the Committee contracted with Touche Ross and Company to conduct an audit of lenders with respect to costs of operating a student loan program and the resultant yield to the lender. The Committee developed additional supporting information and together the results confirm on a detailed basis the general consensus that the special allowance, as restructured by the Congress in the Education Amendments of 1976, is working to the benefit of the GSLP and does provide participating lenders with a more accurate method of assessing current and prospective allowance payments. However, the Committee feels that further consideration should be given to relative administrative costs and money market conditions in setting the special allowance rate.

Specific recommendations of the Committee are:

- that the Congress revise the present statutory formula to provide for a one percent floor on the special interest allowance. This one percent floor would provide lenders with an assured minimum rate of return on their student loan investments and would also assure adequate income to meet administrative overhead and money costs.

- that an additional one-half of one percent yield on student loans in repayment be allowed to the lender to encourage continued diligence in the service of these loans and in recognition of the fact that the procedures required of lenders in this area often exceed the scope and purpose of the normal prudent business standards generally applied to consumer loans by financial institutions.

The Committee further observes that the guaranteed student loan is a complex loan instrument that requires a great deal of effort to comply properly with administrative requirements. To the extent that loan volume is sensitive to administrative costs a dilemma exists in establishing the trade-off between the objectives of the regulation and its effect on lender participation in the GSLP. The Committee feels, therefore, that an intensive cost-benefit analysis of proposed GSLP regulations before implementation by the Department of Health, Education, and Welfare would illustrate the relationship between additional government regulations and the availability of GSLP funds to students and would provide a basis for the constructive re-evaluation of such regulations in light of overall GSLP goals.

## INTRODUCTION

The Education Amendments of 1976 (Public Law 94-482) provide in Section 438(e) for the establishment of a Committee on Process of Determining Student Loan Special Allowances. The Committee is required by no later than October 1, 1977, to submit to the President of the Senate and the Speaker of the House of Representatives a report containing its findings and recommendations with respect to an improved method for determining the special allowance paid to eligible lenders under the Guaranteed Student Loan Program established by Title IV, Part B of the Higher Education Act of 1965, as amended, (20 U.S.C. 1071 through 1087-2).

In accordance with Section 438(e) of Public Law 94-482, the Committee is composed of the Commissioner of Education, the Secretary of Health, Education, and Welfare, the Secretary of the Treasury, and one representative from each of the following groups: state and nonprofit private student loan programs operating under the GSLP; student financial aid administrators; business officers of eligible educational institutions under the GSLP; participating, commercial lending institutions; students; and a representative of the Student Loan Marketing Association (Sallie Mae) as designated by its Board of Directors. The full Committee was appointed by the Commissioner of Education in December 1976. Committee members and designated representatives met to commence deliberations in January 1977. At that meeting Edward A. Fox, a representative of the Student Loan Marketing Association, was elected chairman. Subsequent meetings of the Committee were held in Washington for the purpose of hearing invited representatives of classes of eligible lenders, educational institutions, trade associations, and program administrators present their views on the role of the special allowance in the GSLP.

The establishment of the Committee reflects a strong concern by the Congress to insure the continued effectiveness of the special allowance as an incentive to lenders to participate in the GSLP. The Committee has examined the provisions of the special allowance in light of legislative objectives of assuring that the structure of the allowance or other conditions within the GSLP do not impede its purpose, which is to provide an effective loan

program based on private capital for students attending postsecondary educational institutions. Likewise, the Committee has carefully considered the additional concerns of the Congress that the rate of return realized by the lender be equitable and that the allowance be paid promptly. Further, the special allowance was analyzed in light of the impact of administrative costs incurred by lenders, especially those attributable to Federal regulations and with regard to appropriate money market indices.

In order to insure a thorough review of those factors affecting lenders' perception and acceptance of the special allowance as an incentive to continued participation in the loan program, the Committee engaged Touche Ross and Company, by virtue of their special expertise, to conduct a survey of lenders with respect to costs of operating a student loan program and the resultant yield to the lender. The request for proposal, the costs associated with completing the study as well as other costs incurred by the Committee during preparation of this report are contained in Appendix E.

The Committee specified that an in depth study of program costs at approximately eight financial institutions participating in the GSLP be conducted by Touche Ross. While the Committee was aware of prior surveys and studies of GSLP lenders, it felt that a study of representative lenders utilizing consistent cost and revenue collection methodology would provide valuable input into its deliberative process. The study was designed to provide the Committee with meaningful information regarding loan administration costs and revenues for the surveyed financial institutions as well as information concerning the operational characteristics of the student loan program at these institutions. The resulting information regarding lenders' GSLP yields and the relationship of income to costs for the student loan portfolio of each lender enabled the Committee to evaluate the policies underlying the special allowance in light of specific, objective cost information.

The eight sampled institutions broadly represent those types of commercial lenders who continue to generate significant loan volume either under Federal- or state-administered student loan programs. These selected institutions were chosen in consultation with the Committee and the appropriate guarantor agency and are believed to be in full compliance with the GSLP regulations. All eight institutions indicated a willingness to cooperate with the Committee and shared with the Committee detailed information regarding the costs of their participation in the GSLP. In order to insure a full and free exchange of information the Committee has assured the participating lenders that their identities will not be disclosed. The complete survey, including a

summary of methodology, analysis of lender cost and income information, and Touche Ross' conclusions and recommendations is contained in Appendix A of this report. Additional supporting information developed by the Committee is contained in Appendix C of this report.

The survey results confirm on a detailed basis the general observations of other lenders who provided information regarding program administration costs and yield to the Committee. In formulating its recommendations, the Committee has considered and reviewed the information provided by eligible lenders, especially the information developed by Touche Ross and Company. While acknowledging the high quality of this study, the Committee wishes to emphasize that the survey and its conclusions have been utilized as one of the bases for its recommendations along with data and information developed by the Committee from a variety of other sources.

Before proceeding to the substantive sections of the report, the Committee wishes to note its general consensus that the special allowance as restructured by the Congress in the Education Amendments of 1976, is working to the benefit of the GSLP. The allowance, as tied to the 91-day Treasury Bill, is most effective in assuring lenders of a predictable rate of return. The Committee feels that certain modifications of an operative nature would increase the effectiveness of the special allowance and should be considered by the Congress. Despite the enhancement of the GSLP due to the recent revision of the special allowance formula, there continue to be administrative burdens that limit the allowance's effectiveness. The Committee feels that greater attention to the impact of GSLP regulations, program efficiency, and administrative structure would provide an environment that would maximize the impact of the special allowance.

## THE SPECIAL ALLOWANCE - AN OVERVIEW

With the passage of the Higher Education Act of 1965, a new Federal program of financial assistance became available to students attending postsecondary educational institutions. Designed to make long-term credit for educational purposes available to qualified students, the Guaranteed Student Loan Program relied on a government guarantee and an interest subsidy to induce lenders to provide private capital for educational loans. According to the Senate report on the original bill, the most essential feature of the program was to be "that in emergencies this credit resource can be depended on . . . ." In actuality external economic conditions in the years after 1965 created an uncertain environment for those individuals seeking student loan funds.

In 1968, the Congress revised the interest rate charged to borrowers from 6% to 7% to reflect the current cost of credit. In 1969, the Congress passed the Emergency Insured Student Loan Act (Public Law 91-95). In order to insure students reasonable access to loans for financing their education, the Congress authorized "Federal market adjustment payments" to lenders with respect to insured loans made under the Guaranteed Student Loan Program after August 1, 1969. Essentially a response to rising interest rates and the fear of curtailed lending to students, Congress created a mechanism for increasing the rate of return to lenders during times of monetary stringency without increasing the rate of interest charged to the borrower.

The Secretary of HEW, after consultation with the Secretary of the Treasury and appropriate agency heads, was authorized to prescribe by regulation a special allowance payable by the Commissioner of Education to holders of eligible loans. To be set quarterly, the amount of the allowance was not to exceed 3% of the average unpaid principal balance of eligible loans held by lenders. Determination of the allowance was to be made at the end of each quarter based on the criteria of whether limitations on interest or other conditions caused the return to the lender to be less than equitable and whether these conditions impeded or threatened to impede the purposes of the Guaranteed Student Loan Program.

The Congress continued to authorize the extension of the special allowance provisions of the Emergency Insured Student Loan Act until 1976, when a new allowance mechanism was incorporated into the Education Amendments of 1976. The Congress acknowledged that current fiscal and educational circumstances indicated a continuing need for the Guaranteed Student Loan Program. Their concern focused on improving the structure of the existing program so as to maximize student loan availability. Recognizing that lenders have legitimate interests in receiving reasonable compensation, that they have made substantial contributions to the program, and that the success of the Guaranteed Student Loan Program is fundamentally based on voluntary participation by private lending organizations, the Congress revised the special allowance. Under the terms of the current law, all loans--subsizided or nonsubsidized; federal- or state-guaranteed; educational, commercial, or direct state lender--are eligible for special allowance payments established each quarter. This allowance is to be paid on every loan and for the life of the loan.

Effective January 1977, the special allowance was statutorily tied to the 91-day Treasury Bill. By tying the allowance to a specific indicator the need for direct action by the Secretary of HEW to establish the quarterly rate was eliminated. Thus, the often protracted wait for the publication of the rate experienced by lenders in previous years was removed. The rate to be paid on the average unpaid balance of principal of all eligible loans is now set quarterly by determining the average of the bond equivalent rates of the 91-day Treasury Bill auctioned for the prior three-month period and subtracting 3.5% from the average. The resulting percentage is to be rounded up to the nearest 1/8 of 1% and divided by four. For the first three quarters of 1977, the allowance may range up to a ceiling of 3%; effective the fiscal year beginning October 1, 1977, the ceiling will increase to 5%. In addition, the Commissioner of Education is required to pay penalty interest on interest and special allowance billings beginning 31 days after the receipt of the billing from the lender up to the date payment is authorized by the Federal government. The penalty interest rate is the daily equivalent rate of the special allowance plus 7%.

In a real sense, the restructuring of the special allowance mechanism is a positive response to the need for continued access by students to loans and functions in an effective way to meet the yield expectations of lenders. The Congress recognized that no matter how well structured, and no matter how responsive to money market conditions, the special allowance does not operate in a vacuum. There continue to exist problems of delay and confusion in the GSLP that limit the otherwise beneficial impact of the allowance. Lender response to the Committee's inquiries indicates a continuing concern about these external factors as well as a need

to implement further, limited refinements in the allowance itself. In order to answer these concerns in a positive manner and in accordance with the scope of its Charter by the Congress, the Committee has developed a series of substantive recommendations and conclusions that reflect the long-standing purpose of the Congress to create a special allowance mechanism that encourages the continuing availability of loans through the establishment of an equitable rate of return to the lender.

## SUMMARY OF MAJOR FINDINGS AND CONCLUSIONS

The primary purpose of the special allowance is to ensure that participating GSLP lenders maintain their lending activity and consequently continue to provide the private capital that is essential to the program. However, any analysis of the GSLP that focuses solely on yield is likely to be one dimensional. The financial community predicates its involvement in the GSLP on the concept of community service. This is done with the realization that GSLP loans are not comparable to other consumer loans and generally do not provide the income of consumer loans. This view is further supported by the belief that there are no major corollary benefits to be gained from an institution's involvement in the GSLP. On the other hand, while ascribing a community service motive to financial institutions, it cannot be said that their decision to participate in the GSLP is completely devoid of consideration of rate of return. Thus, the issue of rate of return is intertwined with a broad spectrum of issues that condition lender acceptance of the GSLP as a worthwhile public interest program.

The reasonable expectation of a lender in the GSLP is to obtain an equitable rate of return on his investment. The definition of an equitable rate of return may vary depending on the social and business philosophy of the lender but, in general, may be characterized as an expectation of, at best, a modest profit and, at worst, the realization of no loss from participation in the program. Given this expectation, the revised special allowance, with a modest amount of fine tuning, should adequately meet the reasonable costs incurred by a lender involved in the program.

However, yield cannot be divorced from considerations of administrative regulation. To a large extent administrative burden, both real and perceived, has governed lenders' requests for additional special allowance consideration. This relationship is particularly apparent now that the Education Amendments of 1976 have indexed the special allowance to a widely accepted and predictable indicator of the cost of funds. However, there remains a rather strong feeling in the financial community that the additional costs resulting from increased regulation of the GSLP should be analyzed from a cost-benefit viewpoint before implementation.

If, on one hand, the Congress restructures the special allowance to reflect more fairly the cost of funds and associated reasonable administrative expenses for the GSLP while, on the other hand, the Office of Education is directed to implement additional regulations without weighing the cost to lenders, then the incentive to lend to students is consequently diminished. Insofar as regulations and regulatory changes impose additional administrative and compliance requirements on lenders without strong public policy justification and careful analysis of the benefit to the GSLP, the special allowance mechanism will only be partially effective as an incentive.

The Committee recommendations have been formulated with two main objectives: refining the special allowance to allow lenders to obtain an equitable return on student loan investments and reviewing the GSLP administrative and regulatory processes consistent with maintaining program controls and quality so as to enhance the effect of the special allowance. In attempting to structure an approach to determining what is a reasonable yield and what other factors play a role in lenders' decisions to participate in the GSLP, the Committee utilized the Touche Ross and Company report which provides an in depth review of the costs and revenues associated with financial institutions who are participating GSLP lenders. Additional comments on this subject were solicited from a broad range of lenders and program administrators.

The institutions chosen for the study are broadly representative of the types of financial lenders actually participating in the GSLP. The focus is on financial institutions because the Committee, while acknowledging the role of direct state lenders and educational institutions as lenders under the GSLP, is aware that financial institutions lend the majority of funds under the program and are generally more responsive to financial incentives and regulatory disincentives to lend because of their private sector character.

Of the eight financial institutions, seven are commercial banks and one is a mutual savings bank. The institutions studied are geographically diverse being located in eight different states in the northeast, southeast, midwest, southwest, and west. Of these, four institutions participate in the loan program with the Federal government acting as guarantor while four currently operate under state guaranteed loan programs. Of the eight, each has diverse loan origination policies and differing underwriting standards and one institution, at present, no longer originates any federally guaranteed student loans. Guaranteed student loan portfolios held by these institutions ranged in size from $2.5 million to $27.5 million while total deposits of these lenders ranged from less than $500 million to over $5 billion.

According to the audited data a majority of the lenders studied realized a profit in 1976 on their lending activities. Cost and revenue data collected for the calendar year including direct expenses, actual interest cost of funds and indirect expenses as well as extraordinary items show five lenders with profitable portfolios and three operating at a loss. The spread between adjusted revenue (largely representing interest earned on student loans at 7% plus the special allowance) and expenses and extraordinary items ranged from a loss of 1.19% to a profit of 3.47%. Of the two most profitable programs, one was located in a state where a state guarantee agency offers significant cost-saving support services to lenders and the other was operated by the smallest bank studied which benefited from lower overhead costs of a less urban location and a more stable cost of funds.

SUMMARY OF REVENUE AND COST - ACTUAL INTEREST COST OF FUNDS (1976)

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| Adjusted Revenue | 8.42% | 8.48% | 8.59% | 8.45% | 8.41% | 8.33% | 8.53% | 8.32% |
| Expenses Direct | .94 | 1.18 | 1.61 | 1.70 | 1.21 | 3.21 | 2.67 | 1.76 |
| Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| Indirect | .37 | 1.30 | .72 | 1.30 | .77 | .76 | 1.41 | 1.42 |
| | 4.95 | 6.82 | 6.75 | 7.23 | 5.78 | 9.16 | 8.90 | 9.14 |
| Principal Losses | - | .87 | .09 | - | - | - | - | .37 |
| Spread | 3.47% | .78% | 1.85% | 1.22% | 2.63% | (.83%) | (.37%) | (1.19%) |

Additional data developed by Touche Ross indicate diminished profits if loan profitability was calculated using each institution's internally generated cost of funds for 1976 which represents the lender's full cost of obtaining funds rather than the actual interest cost of funds. By this measure only four institutions operated their student loan portfolios at a profit in 1976. The measure of internal cost of funds is significant because it reflects the institution's individually developed cost of funds

figure that is utilized by management for internal decision-making purposes. Thus, management's perception of its student loan portfolio yield based on this type of cost analysis is likely to be one of the prime determinants in its decision to continue or curtail lending. The study further points out that two of the four profitable programs were only marginally profitable. Again the most profitable programs enjoyed the benefit of significant and effective state guarantee agency support services.

SUMMARY OF REVENUE AND COST - INTERNAL COST OF FUNDS (1976)

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| Adjusted Revenue | 8.42% | 8.48% | 8.59% | 8.45% | 8.41% | 8.33% | 8.53% | 8.32% |
| Expenses | | | | | | | | |
| Direct | .94 | 1.18 | 1.61 | 1.70 | 1.21 | 3.21 | 2.67 | 1.76 |
| Cost of Funds | 4.68 | 5.38 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | 5.98 |
| Indirect | .37 | 1.30 | .72 | 1.30 | .77 | .76 | 2.41 | 1.42 |
| | 5.99 | 7.86 | 7.40 | 8.33 | 7.74 | 9.77 | 10.44 | 9.16 |
| Principal Losses | - | .87 | .09 | - | - | - | - | .37 |
| Spread | 2.43% | (.26%) | 1.19% | .12% | .68% | (1.44%) | (1.91%) | (1.21%) |

Utilizing the same analytical framework for calendar year 1975 based on actual cost of funds reveals that five of the eight institutions' student loan portfolios would have been profitable. Similar analysis for 1974 shows three profitable portfolios and two break-even situations. Figures reflecting internal cost of funds further diminish the number of profitable portfolios to three in 1975 and three in 1974 with one break-even situation.

SPECIAL ANALYSIS FOR PRIOR YEARS - ACTUAL INTEREST COST OF FUNDS

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| 1976 Special Allowance | 1.53% | 1.53 | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% |
| 1976 Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| 1976 Spread | 3.47% | .78% | 1.85% | 1.22% | 2.63% | (.83%) | (.37%) | (1.19%) |
| 1975 Special Allowance | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 |
| 1975 Cost of Funds | 3.89 | 5.35 | 4.70 | 4.71 | 3.63 | 5.81 | 4.54 | 6.04 |
| 1975 Spread | 3.66% | .21% | 1.91% | 1.18% | 3.24% | (1.01%) | (.65%) | (.83%) |
| 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 1974 Cost of Funds | 4.97 | 7.43 | 5.86 | 6.72 | 3.86 | 8.34 | 6.78 | 6.01 |
| 1974 Spread | 3.42% | (1.03%) | 1.59% | .01% | 3.85% | (2.70%) | (2.05%) | .04% |

SPECIAL ANALYSIS FOR PRIOR YEARS - INTERNAL COST OF FUNDS

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| 1976 Special Allowance | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 |
| 1976 Cost of Funds | 4.68 | 5.38 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | 5.98 |
| 1976 Spread | 2.43% | (.26%) | 1.19% | .12% | .68% | (1.44%) | (1.91) | (1.21) |
| 1975 Special Allowance | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 |
| 1975 Cost of Funds | 4.83 | 6.58 | 5.20 | 6.17 | 5.56 | 7.36 | 6.28 | 6.04 |
| 1975 Spread | 2.72% | (1.02%) | 1.41% | (.28%) | 1.31% | (2.56%) | (2.39%) | (.83%) |
| 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 1974 Cost of Funds | 5.78 | 10.36 | 6.27 | 8.22 | 5.75 | 9.63 | 10.18 | 6.03 |
| 1974 Spread | 2.61% | (3.96%) | 1.18% | (1.49%) | 1.96% | (3.99%) | (5.45%) | .02% |

The above data was analyzed to determine net income for 1974-1976 assuming the use of the new special allowance formula established by the Education Amendments of 1976. There would have been no material change in spreads for 1976. However, the modest increase in income for 1975 (approximately .6%) and the substantial increase for 1974 (approximately 1.9%), had the new formula been in place, would have enabled all institutions to be profitable or approach a break-even point using the actual interest cost of funds. On an internal cost of funds basis losses were still suffered by three institutions each year.

While there are a number of differences among loan programs as administered by the eight participating lenders that make unqualified comparisons among the banks studied difficult, certain conclusions regarding the role and significance of the special allowance may validly be drawn. Since the cost of funds represents a significant portion of total costs for each lender studied, an increase in the cost of funds has a substantial impact on the spread between program costs and revenues. The indexing of the special allowance and the raising of the ceiling on the allowance to 5% from the previous 3% ceiling to a large extent mitigates lender concerns in this area. The Committee acknowledges that the impact of increases in the special allowance alone will not significantly alter management decisions to make student loan funds available but feels that a predictable special allowance such as the current formula indexed against the 91-day Treasury Bill provides a stable basis upon which to encourage continued lender participation.

Yield is not only a function of cost of funds; thus, the goal of an equitable yield is not fully met through the special allowance alone. There are a number of other factors that contribute to the cost of maintaining participation in the GSLP. The extent to which these factors impact cost varies among institutions, given differences in administrative organization and loan portfolio characteristics. Among those differences cited by the Touche Ross study are:

- differences in the organization and placement of the student loan processing staff within lending institutions;

- differences in the level of staffing committed to the administration of the student loan portfolio;

- differences in the types of administrative processes utilized in the management of the program by individual lenders; and

- differences in the characteristics of the student loan portfolio of each lender such as the proportion of new loans in the portoflio that require less administrative effort versus loans that have reached repayment status that require significantly higher levels of administrative attention.

Another important variable in determining cost to the lender is the level of guarantor support to the lender. The Committee study indicates that most state guarantee agencies are generally more responsive to lender needs in such areas as administrative guidance and support, and claims assistance and payments. The level of state agency support and efficiency often is a contributing factor in support of continued lender participation in the GSLP. Among those support services performed by one such agency on behalf of the lender are:

- maintaining independent records on all student loan notes outstanding;

- providing student status verification every six months;

- billing the Federal government for interest subsidy and special allowance payments;

- billing interest for nonsubsidized students in an interim status (in-school, in grace or qualified deferment status), except for hardship deferments; and

- performing collection activities on pending claims.

In another state there is a tax incentive that benefits financial institutions who are lenders. This state imposes an annual corporate shares tax on total bank assets. Assets in the form of guaranteed student loans outstanding are exempted from this tax. One state agency provides loan servicing to lenders on a fee basis as well as providing a student tracking service for the purpose of notifying lenders of changes in student status. While the level of services and inducements provided by state guarantee agencies vary, the incentives contained in the Education Amendments of 1976 for the establishment of such agencies and the expansion of their services to lenders is a positive development for the GSLP.

Several of the banks surveyed have curtailed their lending activity and one institution, Bank 8, a mutual savings bank with a relatively high cost of funds during the period studied, has indicated its intention to withdraw from the GSLP as current borrowers complete their education. Among the reasons cited by the bank were:

- high loan delinquency rates;
- delays in claim settlements;
- complex regulations; and
- loss on investment as determined by an internal profitability study.

Reportedly, increases in the special allowance would not affect management's decision to withdraw from active participation in the GSLP.

The reasons cited by Bank 8 are not isolated and are indicative of the complex set of factors that to varying degrees affect the decision to participate in the GSLP. Continued lender participation with its attendant considerations of program profitability is not solely a function of cost of funds. That, in turn, is determined by the type and size of an institution, its financial management philosophy, and the vagaries of the money market. Likewise, program expenses and management outlook are influenced by the characteristics of the individual student loan portfolio and the administrative processes and efficiencies utilized in maintaining that portfolio in compliance with prudent business standards and GSLP regulations.

From the analysis of the Touche Ross study, the testimony from interested parties at its hearings, and the written responses to inquiries, the Committee became aware of the great diversity of costs to the institutions participating in the Guaranteed Student Loan Program. Major money center banks who have a large percentage of their liabilities in the form of interest rate sensitive, short-term money market instruments, tended to have a greater volatility of funds cost than institutions whose liabilities were more heavily weighted toward passbook savings accounts and demand deposits. Additionally, certain institutions were either more adept in their liability management or had a credit standing in the money market community that enabled them to obtain funds at more attractive rates than their competitors. The composition of the liability structure of a financial institution, the administration of liability management and the volatility of the money markets all were determinants of the cost of funds and therefore of net yield on assets to the institution.

Looking at direct and indirect costs it became apparent that geographical location was an important determinant of the expenses in managing a student loan portfolio. Labor, services and rent tended to be significantly higher within the inner city of large urban areas and lower in rural areas. Another determinant of cost was whether the institution was under the Federal program or one of the many state programs. Also, the variety of services and tax incentives offered by one or more of the states created significant differences in the costs of administration among participants. Generally, guarantor policies, support services and efficiencies impact program participation decisions as well as the level of administrative expenses.

The experiences of the eight financial institutions audited in the Touche Ross study, as well as the experiences of the other financial institutions reported to the Committee, generally reflect the experiences of most financial institutions participating in the GSLP. Thus, it would be reasonable to state that the income of most of these institutions exceeds their cost of funds and administrative expenses or at the least enables the institution to break even. The statutory revision prescribing a formula to determine the special allowance has added an element of stability to this situation. However, administrative expenses caused by complex GSLP regulations and the management effort needed to comply with these regulations tends to diminish, if not overshadow, the impact of the special allowance.

It is important to note that the Committee believes that the larger financial institutions that make available a significant portion of the funds under the GSLP are more likely to feel the negative cost effects of program participation cited in the survey. These institutions tend to be in urban areas or are state-wide, thereby incurring higher expenditures due to institutional factors such as size and location. These institutions generally must be more competitive for funds and tend to have a greater percentage of their liabilities in volatile short-term money market instruments, generating a higher cost of funds on average than their smaller rural neighbors. Additional high costs are a function of the larger size of their portfolios, the leadership role expected of such institutions in their community, and the associated administrative costs of GSLP compliance including revisions of computer software systems to meet the requirements of changing GSLP regulations. To the extent that these factors reduce yield, the participation levels among such institutions will drop or be curtailed by establishing student loan eligibliity limitations. Faced with such a set of circumstances, a number of larger lending institutions have withdrawn from the program or curtailed their participation. If this experience is indicative of program trend, other institutions throughout the country will be reconsidering their participation in light of the impact of these varied factors on their individual institutions.

Thus, the cost to a financial institution of participating in the program and the yield to that institution is governed by many factors, some of which are rightly addressed by the special allowance as restructured by the Education Amendments of 1976. Other factors include the structure, geography and diversity of the U. S. banking industry and the relative management styles in that universe of financial institutions, and, finally, the structure and administrative regulations of the GSLP itself.

## RECOMMENDATIONS AND OBSERVATIONS

Consistent with its Charter, the Committee has unanimously agreed to a series of recommendations that attempt to respond to some of the issues raised by lenders and other concerned observers. The Committee considered a wide variety of solutions that were addressed to the diversity of lender expenses, money costs, and yields as well as the variety of differing lender experiences with the GSLP. In part, the Committee feels that the special allowance as now structured does provide participating lenders with a more accurate method of assessing current and prospective allowance payments. Likewise, losses to the lender due to late payments of special allowance billings by the Federal government are now minimized due to the statutory requirement that the Commissioner of Education pay interest on these billings beginning 31 days after receipt of an accurate, timely, and complete request for payment by the Commissioner.

However, the Committee is of the opinion that further consideration should be given to relative administrative costs and money market conditions in setting the special allowance rate. In addition to considerations affecting yield the Committee feels that certain aspects of the GSLP regulatory process have diminished lender participation in the program by increasing expenses associated with program administration thereby making the rate of return less than equitable.

To the extent lenders do not participate in the GSLP, students wishing to obtain loans for postsecondary education purposes suffer. The Committee's recommendations recognize the continued need for student loans and, therefore, seek to establish a climate that would be more conducive to lenders--particularly financial institutions. The recommendations attempt to redress in a cost efficient manner inequities associated with program participation.

The Committee recommends that the Congress revise the present statutory formula to provide for a one percent floor on the special interest allowance. The Committee also recommends that the formula be revised to provide for an increase in the special allowance of one-half of one percent for student loan notes that are in repayment status.

The Committee feels strongly that the revision of the special allowance by the Congress in 1976 was an attempt to remedy the imbalance between the cost of program participation and realization of an equitable yield by lenders and is not a license to unduly increase regulatory burden. More flexible administrative procedures such as the introduction of a "fast break" claims processing system should be introduced by the Office of Education so as to allow a trade-off between necessary increased administrative costs and the special interest allowance. Finally, the Committee urges that all GSLP regulations be analyzed for their prospective cost benefit implications.

One Percent Special Allowance Floor:

A one percent floor on the special allowance would provide lenders with an assured minimum rate of return on their student loan investments. Lenders are often reluctant to commit themselves in the GSLP to any substantial degree without the expectation of a reasonable, guaranteed rate of return that would provide adequate revenues to cover the cost of funds and administrative expenses. This recommendation has been advanced by the Advisory Council on Financial Aid to Students in its Third Annual Report to the Congress dated May 1977. This provision has previously been incorporated in the House of Representatives version of the Education Amendments of 1976.

The purpose of a one percent floor, given the current special allowance formula, is to protect lenders that have more constant sources and costs of funds during periods of low money market rates as well as to compensate for administrative costs. This would encourage additional program participation by commercial banks and savings institutions whose average cost of funds reflects relatively inflexible passbook and savings certificate rates. This is particularly true with regard to savings institutions, such as Bank 8, which because of their structure and source of funds, need the assurance of a reasonable rate of return in order to continue in the GSLP.

A guarantee of a minimum yield on student loans of 8% on a quarterly basis or calculated to assure a minimum annual average rate of return of 8% would not drastically add to the costs of the GSLP. An analysis of historical cost to the Federal government indicates that if a policy of assuring a minimum 8% rate of return on a quarterly basis had been in effect from August 1, 1969, through December 31, 1976, the government would have expended an additional $7.5 million--1.9% of the total special allowance payments made during that period. The same analysis with regard to guaranteeing a minimum annual average rate of return would have required an additional cash outlay of $6.2 million--1.6% of the total special allowance payments made during that period. To the extent that the

revised special allowance formula that became effective January 1, 1977 will result in a somewhat higher yield to lenders than in the past, the cost to the Federal government of providing a 1% floor is further diminished. Appendix D of this report contains detailed cost information regarding this proposal.

Insofar as an equitable rate of return is central to assuring lender participation in the GSLP, a guaranteed floor of 1% resulting in a minimum yield of 8%, combined with the current ceiling of 5% allowing a maximum yield of 12%, all things being equal, should satisfy the vast majority of participating and potential lenders.

Special Allowance Differential

Relative administrative costs to the lender can severely impact rate of return on guaranteed student loans. The Congress cannot realistically provide for a formula that would meet every one of the differing administrative costs associated with GSLP participation. However, there is one area where there is a recognized need to encourage the highest quality of administrative effort. The Committee recommends that an additional one-half of one percent yield be allowed to the lender to encourage continued diligence in the service of loans in repayment status, and in recognition of the fact that the procedures required of lenders in this area often exceed the scope and purpose of the normal prudent business standards generally applied to consumer loans by financial institutions.

Loans in repayment status--those loans where the borrower is no longer enrolled in school, or where payment has been deferred due to service in the Armed Forces, Action or other approved reasons, and the borrower has exhausted his grace period during which no payment is required--need intensive monitoring to assure prompt and continued payment. Restructuring of the special allowance formula with regard to loans in repayment status to provide for a rate of 3.0% subtracted from the average of the bond equivalent rates of the 91-day Treasury Bill auctioned for a given quarter would, in effect, yield an additional one-half of one percent on loans in payout status.

This formula would differ from the current formula that provides for a special allowance on all student loan notes based on a rate of 3.5% subtracted from the 91-day Treasury Bill rate. Data on the volume of student loans in repayment status is currently provided by lenders so that the generation of information to support such a differential payment should be available. A rough estimate of the loan program indicates that approximately 40 to 50% of the nearly $6 billion in student loans outstanding are in

repayment status. Derivatively, the cost of this proposal to the Federal government should range from $12 to $15 million dollars annually. This cost should be balanced by a reduction in loan defaults.

Administrative Regulations:

Lenders justifiably consider the guaranteed student loan as a complex loan instrument that requires a great deal of effort to comply properly with administrative requirements (see Appendix F). Similarly the legislative and executive branches of government are correct in seeking to enforce standards that would protect the student borrowers' interests and those of the Federal government. By and large, regulations governing the GSLP as issued by the Department of Health, Education, and Welfare are a reflection of Congressional intent. Their purpose is to correct perceived program defects--defects that left unattended would ultimately lead to a higher level of loan defaults resulting in direct taxpayer costs. However, additional costs to lenders are implicit in the regulations as written and enforced by the Department of Health, Education, and Welfare. Whenever there is a change in regulations lenders must devote additional dollars to updating computer software, forms and training.

No reasonable individual would object to additional regulations that are necessary and in the best interests of the consumer and the government. However, to the extent that loan volume is sensitive to administrative costs a dilemma exists in establishing the trade-off between the objectives of the regulation and its effect on lender participation in the GSLP. The Committee feels that initiation of an intensive cost-benefit analysis of proposed GSLP regulations before implementation by the Department of Health, Education, and Welfare would further illustrate the relationship between additional government regulations and the availability of GSLP funds to students.

As pointed out in the Committee's survey, Federal procedures regarding default claims submission and payment greatly contribute to the lenders' administrative troubles with the GSLP. State guarantors, in general, are more efficient in honoring their guarantee in the case of a loan default and have instituted timely review systems that expedite lenders' claims. The Office of Education operating in several states must act to protect the Federal government's interests in assuring that claims submitted for payment by a wide variety of lenders under the GSLP are valid and are in compliance with established program standards. No guarantor, whether Federal or state, can be expected to honor claims for payment without reviewing the validity and propriety of such a claim. However, the Office of Eduation can expedite claims submitted by selected lenders without increasing risk to the government by instituting a "fast break" processing system.

Fast break payment systems or their equivalent are already used by other agencies of the Federal government. As applied to the GSLP, selected lenders with approved loan servicing and administrative practices would be eligible to have claims paid when submitted without the delay of individual claims review prior to approval of payment. The government then proceeds to review claims on a post audit basis and when claims are found to have been ineligible for payment they may deduct the appropriate amount from future payments. Such a claims processing system would simplify program administration for approved lenders without compromising GSLP standards. Savings would also accrue to the government in the form of reduced interest payments as the Office of Education is required to pay interest on valid claims submitted by lenders up to the date payment is authorized.

Implementation of a fast break system would be a significant improvement for GSLP lenders. Clearly there are other administrative initiatives that the Office of Education may wish to apply to the GSLP. The Committee feels that serious consideration should be given to identifying and evaluating those additional administrative procedures and processes that would reduce lender burdens while protecting legitimate government interests.

The Committee believes these recommendations will encourage lenders to continue their participation in the GSLP at a modest cost to the government. The continued availability of student loan funds provided through the investment of private capital by GSLP lenders is an integral part of the current student financial aid system. The Committee is confident that the Congress on a periodic basis will continue to review the effectiveness of GSLP inducements and the efficiency of administrative regulations and that the concerns of the Congress as articulated in the charge to the Committee will continue to serve as guideposts in the formulation of program policies.

## APPENDICES

APPENDIX A

COMMITTEE ON THE PROCESS OF
DETERMINING STUDENT LOAN SPECIAL ALLOWANCES

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# STUDY OF THE COSTS TO LENDERS OF PARTICIPATION IN THE GUARANTEED STUDENT LOAN PROGRAM

AUGUST 1, 1977

Touche Ross & Co.

August 1, 1977

Mr. Edward A. Fox
Chairman
Committee on the Process of Determining
Student Loan Special Allowances
c/o Student Loan Marketing Association
1055 Thomas Jefferson Street, N. W.
Washington, D.C. 20007

Dear Mr. Fox:

We are pleased to submit the final report on our study of the costs to lenders of participation in the Guaranteed Student Loan Program.

The data which formed the basis for this report was collected at eight financial institutions, four in state guarantee agency states and four in Federal program states. Although the institutions were carefully selected, the data reported should not be assumed to be representative of all participating lenders.

Each financial institution studied was very cooperative in providing the information required. Our analysis of revenue and cost information is based on the financial reports and other data provided by these institutions. These statements and data were not audited by Touche Ross & Co. and, accordingly, we do not express an opinion on them.



1900 M STREET N.W. - WASHINGTON, D.C. 20036 - (202) 452-1200

We will be pleased to discuss the contents of the report with the Committee at your request.

Very truly yours,

Touche Ross & Co.

cc: Ms. Ellen S. Balko
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U.S. Department of Health, Education and Welfare
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# I. MANAGEMENT SUMMARY

# I. MANAGEMENT SUMMARY

The Committee on the Process of Determining Student Loan Special Allowances was established by the Congress to study the equity of the student loan special allowance. Before recommendations could be formulated concerning the special allowance mechanism, the Committee believed that it was first necessary to understand the costs to lenders of participation in the program. The purpose of this project was to determine the costs and revenue associated with the Guaranteed Student Loan Program (GSLP) for eight participating financial institutions.

The eight institutions studied were carefully screened and selected based on selection criteria approved by the Committee. The lenders studied included two in the northeast, one in the southeast, two in the midwest, one in the southwest, and two in the west. The major characteristics of the eight lenders studied are summarized as follows:

SUMMARY OF BANK CHARACTERISTICS

| Bank Number | Guarantor | Type of Institution | Total Deposits | GSLP Outstandings (million) |
|---|---|---|---|---|
| 1 | State | Commercial Bank | $1-2 billion | $12.9 |
| 2 | State/ Federal | Commercial Bank | $2-5 billion | 14.1 |
| 3 | State | Commercial Bank | $2-5 billion | 8.4 |
| 4 | Federal | Commercial Bank | $2-5 billion | 3.9 |
| 5 | Federal | Commercial Bank | $300-500 million | 6.2 |
| 6 | Federal | Commercial Bank | over $5 billion | 27.7 |
| 7 | State | Commercial Bank | $2-5 billion | 2.4 |
| 8 | Federal | Mutual Savings Bank | $1-2 billion | 11.5 |

We collected cost and revenue data at each of the eight financial institutions studied using a consistent data collection methodology. All cost and revenue data collected are for calendar year 1976.

In spite of the measures taken to assure that the lenders studied are representative, the number of differences among bank

programs and administrative practices make comparisons among the banks studied difficult. Examples of these differences include the following:

- differences in the organization and placement of the student loan processing staff;
- differences in the level of staffing committed to the student loan portfolio;
- differences in the administrative processes utilized to carry out the program; and
- differences in the characteristics of the student loan portfolio such as the extent to which new loans are being originated.

In spite of these differences, we have arrived at certain overall conclusions concerning the program.

Our analysis of the data indicates that the student loan portfolio operated at a profit in five of the eight financial institutions studied and at a loss in the three other institutions studied. The two most profitable programs were Bank 1 which is in a state with a state agency which provides significant support and Bank 5 which was the smallest bank studied. These findings are based on a cost of funds amount representing interest costs but not the costs of servicing demand and time deposits. Our findings for each institution are summarized based on percentages of total GSLP outstandings as follows:

SUMMARY OF REVENUE AND COST - ACTUAL INTEREST COST OF FUNDS (1976)

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| Adjusted Revenue | 8.42% | 8.48% | 8.59% | 8.45% | 8.41% | 8.33% | 8.53% | 8.32% |
| Expenses Direct | .94 | 1.18 | 1.61 | 1.70 | 1.21 | 3.21 | 2.67 | 1.76 |
| Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| Indirect | .37 | 1.30 | .72 | 1.30 | .77 | .76 | 2.41 | 1.42 |
| | 4.95 | 6.82 | 6.75 | 7.23 | 5.78 | 9.16 | 8.90 | 9.14 |
| Principal Losses | - | .87 | .09 | - | - | - | - | .37 |
| Spread | 3.47% | .78% | 1.85% | 1.22% | 2.63% | (.83%) | (.37%) | (1.19%) |

We also analyzed the results using each bank's internal cost of funds utilized for internal decision-making rather than the actual interest cost of funds. As indicated in the following table, this analysis resulted in only four institutions operating their student loan portfolios at a profit during 1976, although two of these programs were only slightly profitable. The two most profitable programs under this analysis, Banks 1 and 3, were both in states with state agencies which perform significant and reportedly effective support activities.

SUMMARY OF REVENUE AND COST - INTERNAL COST OF FUNDS
(1976)

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| Adjusted Revenue | 8.42% | 8.48% | 8.59% | 8.45% | 8.41% | 8.33% | 8.53% | 8.32% |
| Expenses | | | | | | | | |
| Direct | .94 | 1.18 | 1.61 | 1.70 | 1.21 | 3.21 | 2.67 | 1.76 |
| Cost of Funds | 4.68 | 5.38 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | 5.98 |
| Indirect | .37 | 1.30 | .72 | 1.30 | .77 | .76 | 2.41 | 1.42 |
| | 5.99 | 7.86 | 7.40 | 8.33 | 7.74 | 9.77 | 10.44 | 9.16 |
| Principal Losses | - | .87 | .09 | - | - | - | - | .37 |
| Spread | 2.43% | (.26%) | 1.19% | .12% | .68% | (1.44%) | (1.91%) | (1.21%) |

The findings presented above are for a year during which the cost of funds to each institution was relatively low. If one assumed that the relationship of costs and revenue (except for the special allowance) to outstandings were similar in calendar years 1974 - 1976 and that only the cost of funds and the special allowance rate change, then five of the financial institutions studied would have operated their student loan portfolio at a profit in calendar year 1975. In calendar year 1974, three institutions would have operated their student loan portfolio at a profit and two other institutions would have only broken even. The findings of this extension of our analysis utilizing an actual interest cost of funds amount are summarized as follows:

SPECIAL ANALYSIS FOR PRIOR YEARS - ACTUAL INTEREST COST OF FUNDS

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| 1976 Special Allowance | 1.53% | 1.53 | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% |
| 1976 Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| 1976 Spread | 3.47% | .78% | 1.85% | 1.22% | 2.63% | (.83%) | (.37%) | (1.19%) |
| 1975 Special Allowance | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 |
| 1975 Cost of Funds | 3.89 | 5.35 | 4.70 | 4.71 | 3.63 | 5.81 | 4.54 | 6.04 |
| 1975 Spread | 3.66% | .21% | 1.91% | 1.18% | 3.24% | (1.01%) | (.65%) | (.83%) |
| 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 1974 Cost of Funds | 4.97 | 7.43 | 5.86 | 6.72 | 3.86 | 8.34 | 6.78 | 6.01 |
| 1974 Spread | 3.42% | (1.03%) | 1.59% | .01% | 3.85% | (2.70%) | (2.05%) | .04% |

When we conducted a similar analysis for 1975 and 1974 utilizing each institution's internal cost of funds for those years, the impact on the profitability of the student loan portfolio was even more significant. In calendar year 1975, only three of the institutions studied would have operated their portfolio at a profit. In calendar year 1974, three of the institutions would have had a profit and the mutual savings bank would have broken even. These findings are summarized as follows:

SPECIAL ANALYSIS FOR PRIOR YEARS - INTERNAL COST OF FUNDS

| Data Element | Bank Number 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| 1976 Special Allowance | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 | 1.53 |
| 1976 Cost of Funds | 4.68 | 5.38 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | 5.98 |
| 1976 Spread | 2.43% | (.26%) | 1.19% | .12% | .68% | (1.44%) | (1.91) | (1.21) |
| 1975 Special Allowance | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 |
| 1975 Cost of Funds | 4.83 | 6.58 | 5.20 | 6.17 | 5.56 | 7.36 | 6.28 | 6.04 |
| 1975 Spread | 2.72% | (1.02%) | 1.41% | (.28%) | 1.31% | (2.56%) | (2.39%) | (.83%) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 1974 Cost of Funds | 5.78 | 10.36 | 6.27 | 8.22 | 5.75 | 9.63 | 10.18 | 6.03 |
| 1974 Spread | 2.61% | (3.96%) | 1.18% | (1.49%) | 1.96% | (3.99%) | (5.45%) | .02% |

In spite of the frequently low profitability of the Guaranteed Student Loan Program identified above, we were advised that this factor has less influence on lender's willingness to participate than program administration problems. This is supported by the fact that many lenders did not routinely identify the earnings from their student loan portfolio separate from other consumer loans. Our interviews with bank management indicated that the banks were generally willing to participate in the program for community service reasons in spite of the low yield. However, the administrative problems and perceived costs associated with factors such as continually changing requirements and slow claims servicing resulted in a reduced willingness to participate. Consequently, almost all of the lenders studied have taken measures to limit their total investments in the Guaranteed Student Loan Program.

One important indicator of the administrative problems associated with the program is the timing of claims settlement. During our visit to each financial institution, we aged the claims pending on December 31, 1976 from the date of initial filing. Our findings are summarized as follows:

AGING OF PENDING CLAIMS FROM DATE FILED

| Bank Number | Number of Claims Pending (December 31, 1976) | Months Since Date Filed 0 - 3 | 4 - 6 | 7 - 12 | Over 12 |
|---|---|---|---|---|---|
| 1 | 59 | 13 | 46 | - | - |
| 2 | 546 | 369 | 30 | 56 | 91 |
| 3 | 6 | 3 | 2 | 1 | - |
| 4 | 29 | 12 | 16 | 1 | - |
| 5 | 55 | 39 | 16 | - | - |
| 6 | 294 | 223 | 42 | 17 | 12 |
| 7 | 13 | 1 | 11 | - | 1 |
| 8 | 96 | 72 | 4 | 1 | 19 |

During our visit to each financial institution, we discussed with bank management the impact of an increase in the special

allowance rate on their level of participation in the program. As long as the yield remains significantly less than other consumer loan portfolios of the bank (e.g., 10-12%), we were advised that increases in the special allowance would have little impact on the level of participation.

Based on our findings summarized above, we believe that changes in program policies and practices intended to reduce the administrative problems above may be necessary to retain the participation of private financial institutions in the Guaranteed Student Loan Program. We believe that the focus of these changes should generally be on reducing the administrative burden and related perceived costs to lenders rather than merely increasing the yield to offset the increasing costs.

In addition to our conclusions related to the data collected, we have also arrived at several incidental conclusions concerning the Guaranteed Student Loan Program. These incidental conclusions are generally based on our program knowledge gained during the project rather than on the data collected. These incidental conclusions which are presented for consideration by the Committee are as follows:

1. Special allowance mechanism - the cost of funds represents a significant portion of total costs for each lender studied. Significant increases in fund costs will therefore have a significant impact on the spread between revenue and costs for lenders participating in the student loan program. We believe that Public Law 94-482 has effectively reduced the impact of these increases through linking the computation of the special allowance to the ninety-day Treasury bill rate and raising the special allowance ceiling to 5%.

   On the other hand, there may not be adequate protection during periods of low funds costs for institutions which have more constant sources and costs of funds. This was evident in 1976 for the mutual savings bank studied. We believe that a floor on the special allowance should be considered by the Committee in order to retain the participation of these institutions during periods in which the Treasury bill rates are exceptionally low.

2. State guarantee agency services - the costs of portfolio administration appear to be lower and the willingness of lenders to participate appears to be greater in states where a guarantee agency provides effective support activities for participating lenders. These activities include:

   - assistance in interpreting requirements,
   - assistance in tracking the status of students,

- collections assistance, and

- prompt claims settlement including payment of interest on all claims upheld.

We believe that all guarantors should be encouraged to diligently perform support activities such as those identified above. To the extent that such services may be provided more effectively and efficiently at the state level, the activities underway to establish additional state guarantee agencies should be encouraged.

3. Claims settlement - delays in the settlement of Federal claims was a major concern to most lenders studied. We believe that measures should be taken by the Office of Education to settle all claims within one to two months from the date of filing. One approach to expedite claims payment would be to pay claims when filed, review the validity of the claim after payment, and deduct the amount of any denied claims from the next quarterly payment to the lender. Control over this process would be necessary to insure that advance payments do not exceed amounts likely to be due to a participating lender.

4. Federal Program Requirements - the process required to administer a guaranteed student loan portfolio is exceedingly complex when compared to the process utilized by most lenders to administer other consumer loans. We believe that the high direct cost rate (up to 3% of outstandings) experienced by the lenders studied may be attributed at least in part to these complex regulatory requirements.

We have observed a number of requirements resulting from the law or the regulations which appear to produce manual recordkeeping or processing requirements for participating lenders. This additional exception processing is likely to increase the cost of participation in the program. A few examples of requirements which result in exception processing include:

- the existence of several different interest rates which may apply to notes for the same student, depending on the dates of disbursements;

- requirements which allow some notes for a borrower to be eligible for interest subsidy but other notes for the same borrower to be ineligible;

- collection procedures which differ from those utilized for other consumer loans; and

- documentation requirements more detailed than those followed for other consumer loans.

We believe that the law and the regulations should be reviewed with the objective of identifying and reducing, where feasible, requirements which result in costly exception processing.

5. Proposed Regulations - we discussed the proposed student loan regulations dated November 5, 1976 with each participating lender. Although not all lenders were familiar with the proposed regulations in detail, it was evident that certain requirements would result in significant cost increases to selected lenders. This would occur when a lender is not presently administering the student loan portfolio in full accord with the proposed regulations. Examples of the proposed requirements which would be a concern to selected lenders are as follows:

   - conduct of personal interviews during origination;
   - determination of interest using a simple interest method;
   - conduct of periodic status verification for students; and
   - adherence to collection procedures more rigorous than those utilized for other consumer loans.

   We believe that the proposed regulations should be reviewed with the objective of reducing, where feasible, requirements which would result in unwarranted additional costs to participating lenders.

We believe that consideration of the topics discussed above may help to assure the continued role of private financial institutions in the Guaranteed Student Loan Program.

# II. BACKGROUND AND OBJECTIVES

## II. BACKGROUND AND OBJECTIVES

This report identifies the costs to selected lenders of participation in the Guaranteed Student Loan Program. Our study was based on the regulations in effect during 1976. The purposes of this background section are to describe the Guaranteed Student Loan Program, to present the objectives of the Committee on the Process of Determining Student Loan Special Allowances, and to present the objectives of our project.

### The Guaranteed Student Loan Program

The Guaranteed Student Loan Program (GSLP) enables students to borrow directly from qualified lending institutions to pay for the costs of attending eligible post secondary educational institutions. The loans are made at the discretion of the lenders. Such loans are guaranteed by State or private nonprofit agencies or insured by the Federal Government.

A student may apply for a loan if enrolled or accepted for enrollment on at least a half-time basis in an eligible educational institution. Ordinarily, a student may borrow up to $2,500 per academic year as an undergraduate or vocational student. A graduate or professional student may borrow up to $5,000 per academic year although in some States the amount is less. The total amount a student may have outstanding while an undergraduate is $7,500. The aggregate limit for graduate or professional study, including loans made at the undergraduate level, is $15,000.

Most students are eligible for a Federal interest subsidy whereby the Federal Government, rather than the student, pays the interest on the student's outstanding loan during the time the student is in school, during a "grace" period after the student has left the school, and during any authorized deferment of repayment period. The student borrower may take up to ten years to repay the loan. The amount of the payments depends upon the size of debts and the student's ability to pay. In most cases the student must pay at least $360 a year.

### The GSLP Process

The process which a lender must follow in originating and servicing guaranteed student loans is specified in Federal regulations.

A student borrower normally obtains a loan application from a local lending institution. After the student completes their part of the application, the school must complete a portion of this application certifying the student's enrollment, cost of education, academic standing and other financial aid awarded, if

known. The student presents the application to a participating eligible lender. If the lender agrees to make the loan, the lender first obtains the approval of the relevant guarantor, then disburses the loan to the student in one or more payments.

For students in school or a grace period after leaving school, a lender is able to bill for interest only. Lenders normally bill HEW for subsidized borrowers on a quarterly basis and bill nonsubsidized students individually.

When the grace period for a borrower has expired, the lender bills the borrower for both principal and interest, much like other consumer loans. At this point, most lenders place the loan on existing consumer loan computer systems for repayment servicing.

When borrowers become delinquent, the lender is required to follow rigorous collection procedures. If collection procedures fail, the lender is allowed to file a claim for reimbursement from the guarantor, following detailed filing procedures. Assuming the defaulted loan was administered pursuant to regulatory requirements, the guarantor compensates the lender for outstanding principal and in some cases, interest lost as well.

The Special Allowance Rate

Under the student loan program, the annual percentage rate charged to borrowers may not exceed 7%. To compensate lenders for earnings lost when the prevailing market interest rate is above that which students may be charged, the special allowance rate has been established. The special allowance rate, which is determined on a quarterly basis, is the incremental interest beyond 7% which is payable to the lender by the Federal Government based on average eligible outstandings. The special allowance rate up until recently was determined by the Secretary of the Department of Health, Education and Welfare after consultation with the Secretary of the Treasury Department. The special allowance rate is now determined based on the average ninety-day Treasury bill rate for the quarter in question, less 3.5 percent. The resulting percentage is then rounded upward to the nearest one eighth of one percent and divided by four to arrive at the quarterly rate.

The special allowance rate is currently limited to 3%. For any twelve-month period after October 1, 1977, the special allowance rate may average up to 5%.

Committee Objectives

The Committee on the Process of Determining Student Loan Special Allowances was established by the Congress through P.L.94-482. The Committee was established to study the Guaranteed Student Loan Program and to formulate recommendations to the Congress. The specific objectives of the Committee are specified in the law as follows:

- to assure that the limitation on interest payments does not cause a less than equitable return to holders of guaranteed student loans;

- to assure that incentive payments are paid promptly;

- to assure that consideration of administrative costs and money market conditions is made in setting the quarterly rate; and

- to assure that lenders will have a more accurate way to determine the rate for prospective quarters.

The Committee is required to report its findings and recommendations to the Congress by October 1, 1977.

Project Objectives

During early deliberations, the Committee determined that it could not evaluate the equity of the special allowance mechanism without first understanding the costs to lenders of participation in the program. As no current and reliable cost data was available, Touche Ross & Co. was requested to review the financial records of selected lenders to:

- determine the costs to these lenders of participation in the Guaranteed Student Loan Program including:

  -- direct labor costs

  -- other direct costs

  -- cost of funds

  -- overhead costs;

- determine the yield to participating lenders from their student loan portfolio and the relationship between yield and costs;

- identify the reasons for variances in costs among lenders studied; and

- formulate recommendations, as appropriate, for consideration by the Committee.

This report represents the culmination of our project activities.

# III. METHODOLOGY

## III. METHODOLOGY

Our approach to data collection was designed to be responsive to the needs of the Committee for timely and reliable data concerning the actual operating experiences and costs of selected lenders. The purpose of this section is to describe the site selection process, our data collection methodology, key assumptions inherent in our approach, and the data tabulation methodology.

### A. SELECTION OF THE PARTICIPANTS

Considering the relatively small number of lenders studied, it was important that the lenders be carefully selected to be generally representative of other lenders with similar characteristics. For this purpose, we developed the following guidelines for selection which were approved by the Committee:

- four lenders in guarantee agency states and four lenders in Federal program states;
- seven financial institutions with total deposits greater than $1 billion, and one institution with total deposits under $1 billion;
- seven financial institutions with student loan portfolios greater than $5 million, but at least one institution with a smaller portfolio;
- at least one financial institution which has substantially discontinued origination of guaranteed student loans.

Based on these approved guidelines, we worked closely with representatives of the Committee to identify lenders who might meet these requirements. A list of over twenty lenders was developed. For each lender on this list, representatives of the Committee contacted the appropriate guarantor to assure that the lender met the selection requirements and that the lender was in substantial compliance with guarantor requirements.

Based on the guarantor contacts, the list of financial institutions was reduced. For each remaining institution, we conducted telephone screens. The purpose of the telephone screens was to:

- assure the willingness of the lender to cooperate and the availability of key staff personnel for interviews;
- assure that there were no major organizational, systems or program changes during calendar year 1976 which would impact the cost collection approach;

- further verify that lender operating processes were in general compliance with guarantor requirements; and

- determine the availability and retention of source documents required to determine operating costs, cost of funds, and portfolio income for calendar year 1976.

During our conversations with each lender, assurance was provided that the identity of each participating lender would remain confidential.

The findings of the telephone screening and discussions with the Committee Chairman resulted in the approval to schedule visits to the eight financial institutions studied.

B. DATA COLLECTION APPROACH

Our technical approach to data collection was developed during the first phase of our project and was tested at three financial institutions. Our approach was to conduct in-depth, on-site reviews of actual program costs at eight financial institutions using a consistent data collection methodology.

The focus of all cost collection was calendar year 1976. This period was utilized because there were no major Federal program changes affecting costs implemented during 1976. Additionally, the fiscal year for most lenders is also the calendar year and data retention was more likely for a recent period.

The data collection approach is based on data collection forms (Appendix A) and the assumptions to be discussed later in this section. The approach was to utilize records of the lender in order to collect cost by cost category, distribute costs by processing function, and document income earned from the guaranteed student loan portfolio.

We identified four major categories of cost which were collected for each lender. Forms were designed to facilitate data collection by cost category. These categories and the approach to cost collection for each category are as follows:

1. Direct labor costs. Direct labor costs represent the salary and fringe benefits of staff directly associated with the financial institution's student loan program. Direct labor costs were determined based on interviews with the student loan program manager and processing staff to determine:

   - the percent of total time worked on guaranteed student loans during calendar year (CY) 1976;

   - a breakdown of time worked on guaranteed student loans by major processing function; and

- salary and fringes for CY 1976 by each individual assigned to the student loan program.

This analysis of direct labor costs was also conducted for individuals who worked directly on student loan processing functions but were placed elsewhere organizationally.

2. Other direct costs. Other direct costs represent the actual non-labor costs which are directly associated with the operation of the student loan program. These costs typically included:

- occupancy costs;
- furniture and equipment;
- printing, stationery, and supplies;
- postage;
- telephone; and
- data processing.

These direct costs were determined based on a review of departmental expense reports, interviews with student loan program managers, and interviews with the lender's financial staff. Direct costs were generally allocated to specific processing functions based on the distribution of direct processing staff time.

When the reported direct costs were for a large organizational unit which includes the student loan program, and were not broken down to the student loan level, allocations were performed. These allocations of direct costs were normally based on full-time equivalent staffing, although postage and data processing costs were allocated as required based on number of loans.

When individuals placed outside of the consumer loan area of the bank were involved in student loan processing activities, a portion of the "other direct costs" of their units were allocated to the student loan program based on staff time expended.

When other organizational units of the bank provided direct processing services to the student loan program, such as computer servicing, a portion of the costs of that service were allocated to the student loan program based on the number of loans processed.

3. Indirect costs. Indirect costs represent those costs of the bank which are not directly related to student loan processing activities but which can be reasonably allocated to all programs of the bank. These costs are included in total costs but are excluded from our marginal cost analysis. We identified two categories of indirect costs: bankwide overhead costs and department administrative costs.

   Bankwide overhead costs were identified from bankwide expense reports and interviews with the lender's financial staff. These costs were allocated based on the ratio between full-time equivalent operations staff of the student loan program and the full-time equivalent staff of the bank.

   Bankwide overhead costs generally included an allocated portion of:

   - executive and general administrative salaries
   - executive occupancy costs
   - applicable bank services
   - accounting, auditing and payroll
   - personnel
   - other overhead departments such as planning found only in the larger institutions studied.

   In each financial institution studied, the student loan portfolio was administered by a staff located in a larger consumer loan department of the bank. The top management of such departments was not typically involved with student loan processing activities, but was also not part of a bankwide overhead function. We allocated a portion of the costs of this administrative overhead to the student loan program based on full-time equivalent staffing. This allocated cost was then added to the allocated bankwide overhead costs in determining the total indirect costs.

4. Cost of funds. Cost of funds represents the average cost to a lender of obtaining funds. We obtained two measures of the cost of funds at each bank studied:

   - the cost of funds utilized for internal bank decision-making; and
   - the actual cost of funds based on actual balances and interest rates paid (exclusive of deposit servicing costs).

The cost of funds was determined based on interviews with the financial staff of each financial institution and reviews of financial records. Adjustments were made to total funds available to reflect reserve requirements, prior to determining the interest cost of funds. Even though the focus of this study is calendar year 1976, cost of funds amounts for 1974 and 1975 were also collected. This provides a basis for assessing the impact of historical cost of funds and special allowance changes on the profitability of the student loan portfolio.

The cost of funds amount utilized for purposes of our cost analysis was based on the actual interest cost of funds. This approach was utilized because other methods for determining cost of funds differed among the institutions studied. However, we have also determined the profitability of each student loan portfolio using the cost of funds utilized for internal decision-making at each bank studied.

It should be realized that the actual interest cost of funds utilized for our analysis does not include the costs to lenders of servicing their demand and time deposits. Were these costs available, the result would be an increase in the actual cost of funds and an increase in total costs for each lender.

Based on our review of the Federal Reserve's functional cost analysis for 93 banks with deposits greater than $200 million in 1975, the expense of servicing demand deposits was approximately 3% of total demand deposits and the expense of servicing time deposits was approximately .6% of total time deposits. These expenses comprised approximately 22% of the average cost of funds for the 93 banks.

We believe that decisions made by the Committee concerning the student loan special allowance should not be based on costs alone. We believe that the Committee also requires information concerning the yield and spread to lenders from their student loan portfolios. We therefore collected actual income earned from the student loan portfolio for calendar year 1976. The earned income is normally comprised of the following categories:

1. Interest billed to the Federal Government for subsidized students;

2. Interest earned for non-subsidized students in school, grace, or deferral status;

3. Interest earned for borrowers in repayment status;

4. Special allowance received from the Federal Government for the four quarters in calendar year 1976; and

5. Earnings from late charges and other fees.

In addition to determining interest earned from the student loan portfolio, we also determined, as appropriate, losses associated with the student loan portfolio. These losses included:

1. Interest due from non-subsidized students which was written off at the time of conversion to repayment;

2. Interest lost on claims paid for which the guarantor paid principal but not interest;

3. Interest accrued on claims pending during 1976 on notes for which the guarantor will only pay principal at the time of settlement;

4. Losses resulting from claims paid for which the guarantor paid less than 100% of principal;

5. Losses on sales of notes at less than par; and

6. Losses resulting from claims denied during calendar year 1976.

Besides data on costs and revenue, we collected information on the overall characteristics of the student loan program. This information provides the basis for understanding the environment in which the reported costs were incurred. The information collected included:

1. the organization of the financial institution and the placement and organization of student loan processing functions within the institution;

2. the process utilized by the lender for originating and servicing guaranteed student loans, including a description of the systems utilized;

3. the characteristics of the student loan portfolio including:

   - the number of loans originated during the year;
   - the number of loans converted to repayment during the year;
   - the average dollars of loans outstanding during the year;

- dollars of delinquencies as of the end of the year; and
- dollars of claims outstanding as of the end of the year.

4. the procedures used in the administration of the student loan portfolio; and

5. the perceptions of bank management concerning the student loan program.

The assumptions underlying our technical approach and the modifications which were required during tabulation of data unique to individual institutions are described in the following subsections.

C. ASSUMPTIONS

Our technical approach is based on a number of specific assumptions. These assumptions and their rationale were reviewed and approved by the Committee prior to the commencement of data collection activities.

Our assumptions and the related rationale are summarized below. All information presented in Section V is based on these assumptions.

| ASSUMPTION | RATIONALE |
|---|---|
| 1. The costs to each lender of processing guaranteed student loans, irrespective of guarantor, should be collected. | Processing of guaranteed student loans is generally similar for a lender, irrespective of the guarantor, and cost information is not generally maintained by guarantor. |
| 2. The focus of the data collection activities should be to collect information to provide the basis for marginal cost analysis and full cost analysis for each lender studied. | Marginal cost information is generally used for internal bank decision-making so is therefore useful to the banking community in comparing program costs at the lenders studied to their own student loan operations. Full cost information is important to the Committee in developing recommendations concerning the student loan special allowance. |

| | |
|---|---|
| 3. Indirect costs should be allocated on a consistent basis for all lenders and should be allocated based on either staff time or loan volume, depending on the category of cost. | Methods used for allocation of indirect costs differ significantly among lenders. Processing staff time and loan volume data are reasonable bases for this allocation and already required in our study for other reasons. |
| 4. The costs of non-banking operations of a bank, such as insurance or real estate operations, should not be allocated to the student loan program. | Non-banking operations are not reasonably related to the student loan program. |
| 5. The costs of branch information and referral functions should be excluded from the analysis. | These costs are generally nominal and not possible to obtain during a brief site visit. Additionally, procedures may differ among branches of the same institution. |
| 6. Costs to the bank for items such as furniture and equipment will be based on the costs in the bank's accounting system. | Bank accounting systems are normally the only sources for such costs. The effort required to review in detail the assignment and depreciation of items such as desks and equipment cannot be justified. |
| 7. The costs of original system development should not be included as a portion of computer servicing costs. | Computer systems are not typically designed to service only student loans, rather, they are designed to service the overall commercial and/or consumer loan portfolios of the institution. |

D. EXCEPTIONS TO METHODOLOGY UNIQUE TO SPECIFIC INSTITUTIONS

Our data collection activities were performed pursuant to the methodology described earlier. However, in several institutions there was data which required special treatment because of the unique characteristics of that institution's procedures. These modifications are described below:

1. Portfolio Sales. Two institutions (Banks 2 and 8) had sizable sales to the Student Loan Marketing Association (Sallie Mae) during calendar year 1976. As both sales occurred early in the year, we do not believe that this had a material impact on the relationship between costs

and outstandings for the year. However, two adjustments were required in our financial analysis to reflect these sales:

- Bank 2 was charged a fee by Sallie Mae's servicer to cover the costs of notes which were examined and rejected. This fee was a nominal amount and was treated as a direct processing expense.

- Bank 8 sold its outstandings to Sallie Mae at 98% of par. We determined an extraordinary direct expense based on two percent of the outstandings sold.

2. Claims Denied By the Guarantor. Several of the institutions studied had claims denied by the guarantor during calendar year 1976. The amount of such claims denied during calendar year 1976 less subsequent collections from the borrower during the year was treated as a separate expense item for the year.

   One institution studied (Bank 2) had over $100,000 in claims denied by the U.S. Office of Education during CY 76. Although the institution did not write off the denied amount and is continuing attempts to collect from the borrowers, we treated the total amount of claims denied as a separate expense item.

3. Principal Outstanding. Several institutions were unable to readily determine the outstanding principal amount in repayment status. This is because the unearned interest on notes in repayment status was included in the reported outstandings. For these institutions, net outstandings in repayment were computed based on the ratio of unearned interest to gross outstandings at year end. For one institution, an adjustment to earnings was made to reflect what earnings should have been based on the net outstandings.

4. Interest Accruals for Non-subsidized Borrowers. Bank 5 accrued interest for non-subsidized borrowers in school, but rather than billing the borrower while in school, the accrued interest was deferred until conversion to repayment and then added to principal at that time. To fully reflect earnings for the student loan portfolio for calendar year 1976, we counted the interest accrued for non-subsidized students as income even though it would not be collected until after those notes go into repayment status.

5. Interest Lost on Claims. It is the policy of HEW to pay principal only on claims upheld for which the application for a Federal insurance commitment was received by HEW prior to July 1, 1972 or between August 19, 1972 and February 28, 1973.

   Several institutions studied continued to accrue earnings for all notes in claims status, irrespective of the date on which the application for the insurance committment was received by HEW.

   In instances in which it was appropriate, we adjusted accrued earnings to reflect the interest accrued during 1976 for notes in claims status for which HEW would not pay interest even if the claims were subsequently upheld.

6. Data Processing Costs. None of the financial institutions visited utilized commercial servicers to service their student loan portfolios. However, in several instances data processing was provided by a separate subsidiary of the bank which charged the student loan program on a cost per loan basis. Although we were unable to verify that these charges reflected actual costs, we included these charges as a direct cost to the student loan program.

7. Special Allowance Timing. There appears to be a delay between the invoicing of HEW and the receipt of the special allowance. In institutions in which the special allowance was not entered in the accounting records until receipt of the cash, the following adjustments to earnings were required:

   - the special allowance check for the fourth quarter of 1975 was not included in earnings by some banks until 1976. We therefore subtracted this amount from 1976 earnings; and

   - the special allowance check for the fourth quarter of 1976 was not included in earnings by some banks until 1977. We therefore added this amount to 1976 earnings.

   The findings which resulted from the methodology and assumptions described in this section are presented in Section V.

# IV. CHARACTERISTICS OF PARTICIPATING FINANCIAL INSTITUTIONS

## IV. CHARACTERISTICS OF PARTICIPATING FINANCIAL INSTITUTIONS

The criteria for the selection of the financial institutions studied were described in Section III. The purpose of this section is to describe the characteristics of institutions studied so that the costs and revenue data reported in Section V may have more meaning. For each institution studied, we will describe the following characteristics:

- organization and staffing of the institution and the guaranteed student loan function;
- history of the program at the bank and the reasons why student loans are offered;
- characteristics of the guaranteed student loan portfolio;
- processing characteristics; and
- management attitudes concerning the program and plans for future participation.

### A. OVERVIEW

The financial institutions studied included seven commercial banks and one mutual savings bank. The institutions studied included four institutions in state guarantee agency states and four institutions in Federal program states. The lenders included two in the northeast, one in the southeast, two in the midwest, one in the southwest, and two in the west.

The eight institutions together held a total of approximately $90 million in guaranteed student loan outstandings during calendar year 1976. According to data provided by the Office of Education, the institutions studied included four of the largest fifty holders of Federally guaranteed student loans and two of the largest fifty holders of state guaranteed student loans.

The institutions studied were generally large in terms of total deposits since the majority of student loan outstandings are held by large institutions. The institutions studied included five of the largest fifty commercial banks in the country and one of the larger mutual savings banks in the country. Of the remaining two institutions, one had total deposits of under $500 million and the other had total deposits over $1 billion.

The student loan program was normally located organizationally within the consumer lending area of the institution. In seven of the eight institutions studied, there were at least some staff assigned to the student loan program on a full-time basis.

All eight of the financial institutions studied serviced their own student loans and each utilized automated systems to support student loan servicing. However, none of the institutions studied utilized an automated system designed only to service student loans. A typical servicing arrangement was for student loans in interim, grace, or deferral status to be serviced on the commercial loan system of the institution and student loans in repayment status to be serviced on a consumer loan system.

The major characteristics of each institution studied are identified in Exhibit IV-1.

## B. CHARACTERISTICS OF BANK 1

### Bank Description

Bank 1 is a commercial bank with total deposits between $1 and $2 billion. The bank has over 1,500 personnel. Bank 1 is organized into five major divisions: trust, management services, corporate banking, operations, and retail banking. The student loan program is located within the consumer credit function under the retail banking division. Servicing for student loans is also provided by the operations division.

### Description of the Guaranteed Student Loan Program

A student loan program was initiated at Bank 1 in 1957 through a predecessor to the Federal program. Bank 1 became involved in the Guaranteed Student Loan Program upon its establishment. Bank 1 is involved in the student loan program for community service reasons. The student loan outstandings of Bank 1 have grown only twenty percent during the past four years, although there is no ceiling on GSLP outstandings. Bank 1 imposes no unique qualifying requirements on applicants, following an "open door policy" for student loans.

Bank 1 had average student loan outstandings of almost $13 million during 1976. The student loan outstandings of Bank 1 include $16,000 guaranteed by a private school. Approximately 60% of the outstandings are for loans in interim status, representing over 5,000 of the 8,400 loans outstanding. During 1976, approximately 2,500 notes were originated representing total originations of almost $3.5 million.

EXHIBIT IV-1

SUMMARY OF CHARACTERISTICS
OF FINANCIAL INSTITUTIONS STUDIED

| | BANK 1 | BANK 2 | BANK 3 | BANK 4 | BANK 5 | BANK 6 | BANK 7 | BANK 8 |
|---|---|---|---|---|---|---|---|---|
| Total Bank Deposits | $1-2 billion | $2-5 billion | $2-5 billion | $2-5 billion | $300-500 million | Over $5 billion | $2-5 billion | $1-2 billion |
| Guaranteed Student Loan Outstandings (1976 Average) | $12.9 million | $14.1 million | $8.4 million | $3.9 million | $6.2 million | $27.7 million | $2.4 million | $11.5 million |
| % of Outstandings in Repayment Status (12/31/76) | 40.4% | 45.5% | 22.3% | 48.6% | 58.5% | 51.3% | 44.5% | 73.6% |
| Guarantor | State | State/Federal | State | Federal | Federal | Federal | State | Federal |
| Originating Notes to New Borrowers? | Yes | No | Yes | Yes | Yes | No | Yes | No |
| Full Time Equivalent Staffing for Guaranteed Student Loans | 7.03 | 10.84 | 7.11 | 3.20 | 3.80 | 49.47 | 3.05 | 9.40 |
| FTE Staff/Million Dollars in Outstandings | .55 | .77 | .85 | .83 | .61 | 1.78 | 1.26 | .82 |
| Claims Pending Over 6 months on 12/31/76 | -0- | 147 | 1 | 1 | -0- | 12 | 1 | 19 |
| % of Repayment Outstandings Delinquent Over 30 days | 9.6% | 28.1% | 10.5% | 20.7% | 14.1% | 13.0% | 6.0% | 14.3% |
| Program Administration Characteristics: | | | | | | | | |
| Branch Participation in Origination? | No[1] | Yes | Yes | No | No | Yes | No | Yes |
| Personal Interview During Origination? | No[1] | No | No | Yes | Yes | Yes | Yes | Yes |
| Credit Checks During Origination? | Yes[5] | No | Yes | Yes | No | Yes | No | No |
| Status Verification for Interim Borrowers? | No[2] | No | No[2] | Yes | Yes | No | No | No |
| Automated System for Interim Notes? | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Automated System for Repayment Notes? | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Basis for Interest on Interim Notes? | Simple | Simple | Simple | Simple | Simple | Simple | Simple | Simple |
| Basis for Interest on Repayment Notes? | Rule of 78's | Rule of 78's | Rule of 78's | Rule of 78's | Rule of 78's | Simple | Rule of 78's | Simple |
| Bill Guarantor for Subsidized Students? | No[2] | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Bill Nonsubsidized Students? | No[2] | Yes | Yes | Yes | No[3] | Yes | Yes | Yes |
| Unusual Aspects of Program in 1976 | - | Claims Denied, Sale to Sallie Mae | - | - | - | - | - | Sale to Sallie Mae |
| Direct Costs as a Percent of Outstandings [4] | .94% | 1.18% | 1.61% | 1.70% | 1.21% | 3.21% | 2.67% | 1.76% |
| 1976 Cost of Funds (Actual Interest Cost) | 3.64% | 4.34% | 4.32% | 4.23% | 3.80% | 5.19% | 3.82% | 5.96% |
| Spread for 1976 Using Actual Interest Cost of Funds | 3.47% | .78% | 1.85% | 1.22% | 2.63% | (.83%) | (.37%) | (1.19%) |

1/ Only if student brings in the application
2/ Guarantor performs function
3/ Accrue interest until conversion
4/ Detailed breakdown and explanation of this data is provided in Section V
5/ Credit checks performed only for students over 21 or over 18 and financially independent

Program Administration

Bank 1 is located in a guarantee agency state. The state agency performs the following functions on behalf of participating lenders:

- maintains independent records on all notes outstanding;
- provides status verification every six months;
- bills HEW for the subsidy and the special allowance;
- bills nonsubsidized students in interim status, except for hardship deferments; and
- performs collection activities on pending claims.

Bank 1 has a full-time equivalent staff processing student loans of over 7 people within the consumer lending function and approximately .2 additional full-time equivalent staff in the operations function. The consumer lending staff performs origination functions through disbursement, prepares bills for interim nonsubsidized students with hardship deferrals, and converts loans into repayment status. The consumer lending staff is also responsible for delinquency follow-up activities. The operations staff is responsible for payment processing and interface with the state agency billing system.

All student loans are originated in the central office, although branches distribute applications. Personal interviews are not required and are normally not conducted either at origination or conversion. Credit checks are utilized only for borrowers who are either over age 21 or over age 18 and financially independent. A state agency fee is deducted from the loan amount at the time of disbursement. Disbursements are made payable to the student and the school and are normally distributed to the student in person in either the central office or a branch.

Bank 1 utilizes an automated commercial loan system for servicing notes in interim status and an automated consumer loan system for servicing notes in repayment status. Interest on interim notes is computed on a simple interest basis. Interest on notes in repayment status is determined based on the rule of 78's. Interest is remitted by the state agency for subsidized students, nonsubsidized students, and the special allowance on a quarterly basis. Nonsubsidized students who are billed directly by Bank 1 are invoiced on a

quarterly basis. There is no formal status verification conducted by Bank 1 as the state agency performs that function.

When conversion to repayment status occurs, all notes for a student are combined into a single repayment schedule. A coupon book is utilized for each borrower in repayment status.

When student loans become delinquent, the bank utilizes a number of collection techniques including:

- calls to parents;
- letters to last known addresses;
- letters to schools; and
- contact of references listed on the application.

The state agency requires that claims be filed with the state sixty days after a note has become delinquent. This reportedly results in over sixty percent of the claims filed being returned to repayment status. The state agency pays 100% of principal and interest on claims upheld.

Current Attitudes and Plans for Future Participation

Bank 1 plans to continue involvement with the Guaranteed Student Loan Program subject to the results of future internal profitability studies. The program is not being actively promoted by the bank. Bank management indicated that the level of the special allowance has not influenced student loan investment decisions and is unlikely to do so in the future.

C. CHARACTERISTICS OF BANK 2

Bank Description

Bank 2 is a commercial bank with total deposits between $2 billion and $5 billion. The bank has over 3,300 personnel. Bank 2 is organized into two major areas: (1) trust and commercial operations, and (2) consumer and retail operations. The student loan program is located in the direct loans unit of the consumer loan division. Servicing for student loans is also provided by the accounting information function within direct loans and by the commercial loans function of the bank.

Description of the Guaranteed Student Loan Program

A student loan program was initiated by Bank 2 in 1962 through a predecessor to the Federal program. Federally

guaranteed notes to students attending a proprietary school were originated between 1973 and early 1976. In addition, Bank 2 purchased Federally guaranteed loans to students attending the same proprietary school. The student loan outstandings of Bank 2 have grown by a total of 25% during the past four years. Bank 2 is reportedly in the student loan program for community service reasons.

Bank 2 is in a state which imposes an annual corporate shares tax based on total bank assets. However, guaranteed student loan outstandings are exempted from the tax.

Bank 2 has made student loans only to students already holding state guaranteed loans during the past year. A budgetary ceiling has been placed on funds available for student loans. Bank 2 is no longer originating any Federally guaranteed student loans.

Bank 2 had total outstandings of over $14 million during 1976. The outstandings included over $8.5 million in state guaranteed notes and over $5 million in Federally guaranteed notes. Almost sixty percent of the student loan holdings of Bank 2 are for students in interim status. During 1976, approximately 1,200 notes were originated for existing borrowers, representing total originations of slightly under $2 million.

Bank 2 sold over $3.5 million in student loan outstandings to Sallie Mae in January, 1976. A sale of slightly over $1 million was made in January, 1977.

Program Administration

Bank 2 is located in a guarantee agency state. The state agency provides collections assistance to lenders in the state.

Bank 2 has a full-time equivalent staff processing student loans of approximately 8.7 people within direct loans, .6 persons within accounting information, and .7 persons within commercial loans. The direct loans staff originates student loans, performs routine servicing activities, and is responsible for collections and claims filing. The direct loan staff also prepares the subsidy and special allowance billings. The commerical loans staff is responsible for automated records for student loans in interim status. The accounting information staff is responsible for automated records for student loans on the consumer loan system and for payment processing.

All student loan originations are performed in the central office, although some branches perform a referral function. Personal interviews are not required at either

origination or conversion. Credit checks are not utilized. Bank 2 deducts the required insurance premium from the loan proceeds prior to disbursement. Disbursements are payable to the student and mailed directly to each student.

Bank 2 utilizes an automated commercial loan system for servicing interim notes and an automated consumer loan system for servicing notes in repayment status. Interest on interim notes is computed on a simple interest basis. Interest on notes in repayment status is determined based on the rule of 78's. Billing of subsidized students, nonsubsidized students, and the special allowance is on a quarterly basis. There is no status verification conducted for students in school.

When conversion to repayment occurs, all notes bearing the same interest rate for a student are combined into a single repayment schedule. A coupon book is utilized for each borrower in repayment status.

When student loans become delinquent, the bank utilizes a number of collection techniques including:

- computer generated late notices;
- phone calls from collectors; and
- typed notices from collectors.

Claims are filed with either the state agency or HEW depending on the guarantor of the defaulted note. During 1976, Bank 2 had over $100,000 in Federal claims denied by the U.S. Office of Education. The state agency denied no claims during 1976 and paid 100% of the claim amount including interest on all claims settled.

Current Attitudes and Plans for Future Participation

Bank 2 has participated in the student loan program reportedly to satisfy social needs. Due to claims settlement problems with HEW, Bank 2 ceased originations to new students during early 1976. At present, Bank 2 only makes student loans for state guaranteed students who are already borrowers. Bank 2 has no plans to obtain any additional Federally guaranteed student loans in the future.

Bank 2 is satisfied with its relationship with the state agency. Assuming that claims with HEW are settled, Bank 2 will likely become more involved with the origination of state guaranteed loans, at least up to the amount of Federal

claims pending. However, Bank 2 plans to sell future originations to Sallie Mae rather than servicing such notes internally.

An increase in the special allowance without a reduction in regulatory requirements would reportedly have little impact on the level of participation of Bank 2 in the student loan program.

D. CHARACTERISTICS OF BANK 3

Bank Description

Bank 3 is a commercial bank with total deposits of between $2 billion and $5 billion. The bank has over 3,000 personnel. Bank 3 has an overall organization structure comprised of a loans division, an executive support function, trust and corporate support functions and an operations division which services all of the other divisions and also performs the primary banking functions such as branch operations and deposit operations. Both the loan and operations divisions perform direct student loan processing activities.

Description of the Guaranteed Student Loan Program

The Guaranteed Student Loan Program was initiated at Bank 3 in 1968. Growth of outstandings has been limited to approximately 8% per year. Bank 3 initially became involved in the program for two reasons: (1) to provide a community service; and (2) to generate subsequent business with student loan borrowers.

Bank 3 provides guaranteed student loans to any state resident, up to the amount budgeted for the year. Borrowers are required to have a comaker sign the promissory note. The state reportedly encourages lenders to use comakers although this is not a state requirement.

Bank 3 had average student loan outstandings of over $8 million during 1976. Approximately 75% of the outstandings are in interim loans, representing approximately 3,000 of the 4,500 loans outstanding. During 1976, approximately 1,600 notes were originated representing total originations of about $2.75 million.

Program Administration

Bank 3 is located in a guarantee agency state. Bank 3 services its own portfolio rather than utilizing the servicing provided for a fee by the state agency. The state agency provides a student tracking service through providing

mailers to schools for notifying lenders of changes in student status. The state reimbursed lenders for claims at a rate of 90% during 1976.

Bank 3 has a student loan processing staff of approximately 5 people within the installment loan department. This staff performs origination functions though disbursement, interim HEW billing and conversion. Separate sections of the installment loan department provide credit investigation and collections support. Interim and repayment accounting functions are performed by the loan operations division.

All student loans are originated in the central office. Branches may provide applications to students; however, the decision to disburse is made by the centralized student loan office. Personal interviews are not required at the time of initial application or at conversion. External credit checks are performed for both the student and the comaker of the loan. Insurance premiums are prepaid by the student prior to disbursement. Disbursements are then made in the form of certified checks or money orders payable to both the student and the comaker of the loan.

An automated system is used for servicing both interim and repayment notes. Interest charges on interim loans are computed manually for both subsidized and nonsubsidized students, using simple interest on outstanding principal balances. Both subsidized and nonsubsidized interest billings are prepared quarterly.

Contacts with students in interim status are limited to the school mailers provided by the state. When Bank 3 receives a mailer from the school, attempts are made to contact both the student and the comaker.

Conversion activities are initiated with a letter of congratulations to the student at the time of graduation. If the student does not contact Bank 3, a series of four letters is sent to the student and the comaker. If the student contacts Bank 3, a repayment schedule is prepared and mailed to the student. A signature is not required on the repayment schedule.

All loans for a student which are at the same rate of interest are consolidated at conversion. Interest for notes in repayment status is determined based on the rule of 78's. Coupon books are utilized for all notes in repayment status.

During repayment, the automated system generates notices for delinquent accounts. Delinquency reports are system generated and sent to the collections unit. Collection efforts are initiated with a call to the student. Letters are then sent and another attempt is made to

telephone the student. If the account is three months delinquent, comakers are contacted. Credit checks are run for students who have not been located. Claims are filed by collections staff after 120 days.

Current Attitudes and Plans for the Future Participation

Bank 3 plans to maintain guaranteed student loan outstandings at approximately the current level in the future. Reportedly, outstandings will not be increased unless there is a significant increase in the yield of the loans to bring the return on student loans up to the level of other installment type loans. Although the risk on student loans is low, Bank 3 has experienced a very low default rate on other loans and therefore believes that the administrative costs required to process student loans exceeds that of other similar loans.

E. CHARACTERISTICS OF BANK 4

Bank Description

Bank 4 is a commercial bank with total deposits of between $2 billion and $5 billion. Bank 4 has over 1,350 personnel. Bank 4 is organized into six major divisions: trust, administrative, international, investment, finance, and domestic banking. The student loan program is located under the consumer lending function within the domestic banking division. Servicing for student loans is also provided by the loan adjustments unit within consumer lending and by the loan processing unit within the administrative divison.

Description of the Guaranteed Student Loan Program

The Guaranteed Student Loan Program was initiated in 1968 at Bank 4. Bank 4 is reportedly involved in the student loan program for community service reasons. Although Bank 4 is one of the few lenders in its area which make student loans, its outstandings have grown only gradually within the past few years.

This slow growth appears to be the result of the following qualifying requirements which Bank 4 imposes on all applicants:

- the student or parents must be permanent residents of the city within which Bank 4 is located;
- the student or parent must have an active and properly managed checking or savings account with the bank; and

- the account must have been in existence at least one year prior to the application for a student loan.

Bank 4 had average student loan outstandings of under $4.0 million during 1976. The outstandings were evenly distributed between interim loans and loans in repayment status. During 1976, approximately 280 student loans were originated by Bank 4 representing total originations of over $440,000.

Program Administration

Bank 4 is located in a Federal program state. Bank 4 has a full-time equivalent staff processing student loans of approximately 2.5 persons within consumer lending and approximately .75 persons within the loan operations function. The student loan staff within consumer lending is responsible for origination through disbursement, collection activities for delinquent interim notes, preparation of subsidy and special allowance billings, and the filing of claims. The loan adjustments staff within consumer lending is responsible for collection activities for delinquent loans in repayment status. The loan operations staff is responsible for automated record maintenance, payment processing, and adjustments.

All student loans are originated in the central office. Personal interviews are required for all applicants at the time of origination. However, personal interviews are not always utilized for current borrowers seeking additional funding. Retail credit checks are obtained for all applicants for student loans. The required insurance premium is deducted from loan proceeds at the time of disbursement. All disbursements are then made payable to the student but mailed to the school.

Bank 4 utilizes an automated system for servicing student loans. Separate codes are utilized to distinguish student loans in interim and repayment status. Interest on interim notes is computed on a simple interest basis. Interest on notes in repayment status is determined based on the rule of 78's. Billings to HEW for the subsidy and special allowance and to nonsubsidized students are performed on a quarterly basis. Bank 4 performs status verification through requesting fee slips every semester from all borrowers in school. Schools are contacted for all borrowers for whom fee slips are not received.

When conversion to repayment status occurs, all notes bearing the same interest rate for a student are combined into a single repayment schedule. A coupon book is utilized for each borrower in repayment status.

When student loans become delinquent, the bank utilizes a number of collection techniques including:

- computer generated notices,
- letters to schools, and
- telephone calls and personal letters to the borrower.

Current Attitudes and Plans for Future Participation

Bank 4 plans to continue participation in the student loan program at the current level of outstandings. Bank top management is committed to the program and views it as providing a community service as well as a service to depositors. Bank 4 would view an increase in the special allowance rate as an incentive to continue involvement in the program.

F. CHARACTERISTICS OF BANK 5

Bank Description

Bank 5 is a commercial bank with total deposits of between $300 million and $500 million. Bank 5 has approximately 500 personnel. The organization of Bank 5 is divided in four groups: loans, trust, corporate planning and administration. The student loan office is located within the installment loan department of the loans division. All direct processing of guaranteed student loans is performed by the installment loan department including payment processing functions.

Guaranteed Student Loan Program

A student loan program was initiated at Bank 5 in 1963 with the United Student Aid Funds Program (USAF). Bank 5 participates in the student loan program as a community service and reportedly to assist in increasing the educational level of the community. The GSLP portfolio has grown at a rate of approximately 8% per year over the last 5 years.

The GSLP portfolio consisted of approximately $2.5 million in interim notes and $3.5 million in repayment notes for total outstandings of $6 million. During 1976, approximately $850,000 in new loans were originated.

Bank 5 makes loans only to students whose parents are bank customers.

Program Administration

Bank 5 is located in a Federal program state. All origination functions are performed centrally. Bank 5 requires a personal interview during loan origination, but does not require a personal interview at the time of loan conversion. Credit checks are not performed during origination.

HEW insurance premiums are collected and deducted from the note amount at the time of disbursement. Prior to 1976, disbursements were made to the school only. During 1976, the disbursements were made payable to the student and the school.

Student status is checked twice a year by Bank 5 through sending confirmation reports to the school. HEW is billed quarterly for subsidized students. However, all interest for nonsubsidized interim loans is accrued and then added to the principal balance at conversion to repayment.

Both interim and repayment notes are maintained on an automated system. The system accrues interest on a simple interest basis for notes in interim status and based on the rule of 78's for notes in repayment status.

All notes bearing the same interest rate for a student are combined into one repayment schedule. Repayment schedules and initial notifications are prepared and sent to the student. If the repayment schedule is not returned, two additional letters are sent one month apart with a certified copy to the parents at the time of the third letter. If the student still has not responded, preclaims assistance is requested from OGSL and a letter requesting payment in full is sent to the student. A final letter is sent to the student prior to filing a claim at 120 days. After the claim is filed, a letter is sent to the student stating that the claim has been filed.

If the repayment note is signed and returned, the loan is set up as a repayment note and a coupon book is sent to the student. Computer generated notices are sent out for delinquent payments at intervals of approximately one month up to the point that three payments are past due. At this point, a letter requesting payment in full is sent. If there is no response after 120 days, a claim is filed.

Current Attitudes and Plans for the Future

Bank 5 plans to maintain the student loan portfolio at approximately the current level. If the cost of funds increases significantly, the level of new student loans may decrease. To increase the student loan portfolio, Bank 5 would require a yield equivalent to other consumer loans and

suggests that special benefits be established for student loan lenders including tax exempt income status and receipt of government deposits.

G. CHARACTERISTICS OF BANK 6

Bank Description

Bank 6 is a commercial bank with total deposits of over $5 billion. Bank 6 has over 17,000 personnel. Bank 6 is organized into nine major operating groups: bank support, corporate banking, credit, fiduciary services, financial, international, investments, operating services, and two regional branch services groups. The student loan program is located within the bank support group under the consumer finance function.

Description of the Guaranteed Student Loan Program

The Guaranteed Student Loan Program was initiated at Bank 6 in 1968. Bank 6 is involved with the student loan program for community service reasons. The student loan outstandings of Bank 6 have declined approximately ten percent during the past four years. This is the result of a decision in March, 1976, to limit originations to current borrowers.

Bank 6 imposes the following qualifying requirements on applicants for student loans:

- no loans to applicants aged 26 or over;
- no loans to freshman students;
- school attendance must be in a day time program on a full-time basis;
- parent's cosignature if the applicant is under 18 years of age; and
- no Federally insured loan with any other qualified lender.

Bank 6 had average student loan outstandings of over $27 million during 1976. The outstandings were fairly evenly distributed between interim notes and notes in repayment status. During 1976, approximately 2,500 notes were originated representing total originations of over $2.6 million.

Program Administration

Bank 6 is located in a Federal program state. Bank 6 has a full-time equivalent staff of approximately 49 persons responsible for processing student loans. All student loan origination and servicing activities are performed by the student loan unit within the consumer finance function. However, data processing and payment processing services are provided by the data processing function of the bank.

All GSLP notes are originated centrally including the decision to disburse. However, branches frequently accept applications and perform credit checks prior to forwarding documentation to the central student loan staff for processing. Personal interviews are required as part of the origination process. A retail credit bureau is utilized to obtain credit reports on all applicants. The required insurance premium is deducted from loan proceeds at the time of disbursement. The disbursement check is mailed to the school but made payable to the student.

Bank 6 utilizes an automated system for servicing student loans. Separate coding is utilized to identify the status of the various categories of borrowers. Interest on both interim notes and notes in repayment status is determined on a simple interest basis. Interest is billed on a quarterly basis to HEW for the subsidy and special allowance and also on a quarterly basis directly to nonsubsidized students. There was no annual status verification performed by Bank 6 for students in school although plans are currently underway to implement such verification.

A computer generated notice is sent to the borrower prior to conversion. When conversion to repayment occurs, all notes bearing the same interest rate for a student are combined into a single repayment schedule. However, no new note is signed at the time of conversion. A coupon book is utilized for each borrower in repayment status.

When student loans become delinquent, the bank utilizes a number of collection techniques including:

- periodic computer generated notices;
- telephone calls and letters; and
- the demand letter.

Bank 6 had over $1.3 million in claims pending at the beginning of 1976, which was reduced to less than $400,000 in claims pending at the end of 1976.

Current Attitudes and Plans for Future Participation

Bank 6 is originating student loans only for current borrowers. The bank plans to continue some level of participation in the program. The establishment of a state guarantee agency could have a positive impact on the participation of Bank 6 in the program.

An increase in the special allowance by itself would reportedly have no influence on the level of participation of Bank 6 in the program. Claims settlement problems and regulatory requirements would also have to be improved prior to significant increases in the participation of Bank 6.

H. CHARACTERISTICS OF BANK 7

Bank Descriptions

Bank 7 is a commercial bank with between $2 and $5 billion in deposits. Bank 7 has a full-time staff of over 3,000 personnel. Organizationally, the bank has three major organization units consisting of banking, operations support and banking services. The guaranteed student loan processing occurs within the banking and operations functions. Within the banking division, the student loan staff is located within the installment loan division.

Guaranteed Student Loan Program

The Guaranteed Student Loan Program was initiated in 1966 at Bank 7. The student loan outstandings have grown a total of 25 percent during the last five years from slightly less than $2 million to a current level of approximately $2.5 million. Bank 7 initially entered the student loan program to provide a community service and has purposely limited the growth of its outstandings. During 1976, the bank made loans to any student who was a resident of the state and who maintained a C+ average, up to their budgeted ceiling.

During 1976, Bank 7 originated slightly over 300 loans representing approximately $500,000 in new loans. The average number of outstanding interim loans during 1976 slightly exceeded 1,000 representing approximately $1.4 million in outstandings. There were approximately 700 notes in repayment status for $1.1 million. The total student loan portfolio represents approximately $2.5 million in outstandings.

Program Administration

Bank 7 is located in a guarantee agency state. The state approves applications and provides limited preclaims

assistance. The state reimburses lenders at 100% of claims value including interest on all claims. The state does not assist lenders in billing or collection efforts.

The GSLP staff of Bank 7 consists of one person who performs the origination and conversion activities. Support of slightly less than one person is provided for collections. Additional support of approximately one person is provided in the operations division which performs the interim billing and repayment activities.

The origination process is performed in the central office and is initiated with a personal interview with the student and their parents. External credit checks are not performed. A second interview is required when the student signs the promissory note. The state does not require insurance premiums. Disbursement checks are made payable to the student and mailed to the school.

Contact of students during interim status is limited to notifications of change in status by the school or student. HEW is billed quarterly for subsidized students and the special allowance. Nonsubsidized students are also billed quarterly for interest. All interim interest is calculated on a simple interest basis by the automated loan system. However, interest billings are prepared manually.

Congratulation letters are sent to students at the time of graduation. The student is contacted by phone following the letter and is urged to sign the repayment note. A second letter is mailed to the student five months following graduation. A mail-gram is sent if there is no response by the sixth month. Finally, references are called if there has been no response from the preceding attempts to contact.

At the time of conversion to repayment, notes for a student bearing the same interest rate are consolidated. The loan is transferred to the consumer loan system after unearned interest is manually computed. Coupon books are prepared and mailed to the student. Delinquency notices are computer generated.

Collection procedures are the same as the procedures described for conversion to repayment. A letter requesting payment in full is sent after 90 days and a claim filed after 120 days of delinquency.

Current Attitudes and Plans for Future Participation

During early 1977, Bank 7 restricted its qualifying criteria for the program. Students must now be current bank customers and cannot be freshmen. Additionally, loans will no longer be made to students attending proprietary schools. Future growth in the level of outstandings will be restricte

to no more than 8 percent. Reportedly an increase in the special allowance would not significantly change the participation of Bank 7 in the program.

## I. CHARACTERISTICS OF BANK 8

### Bank Description

Bank 8 is a mutual savings bank. Bank 8 has total deposits of between $1 billion and $2 billion. Staffing for Bank 8 is slightly less than 700. Bank 8 is organized into a primary bank service division comprised of consumer loans, real estate and commercial services. Other divisions providing support to the primary service division are organized by operations, administrative and regional support functions. The Guaranteed Student Loan Office is located within the consumer loans section. Additional processing functions are performed by the operations division.

### Guaranteed Student Loan Program

The student loan program was initiated in 1969 at Bank 8. Bank 8 reportedly entered the program to provide a community service and to use student loans as a means of obtaining subsequent business. From 1969 to 1973, the outstandings grew rapidly to a total of approximately $22 million. During 1973, Bank 8 made the decision to withdraw from the program. New loans were made only to current borrowers and large sales were subsequently made to Sallie Mae. The current GSLP portfolio includes approximately $2 million in interim loans and $8 million in loans in repayment status for a total outstandings of slightly less than $10 million.

During 1976, originations were limited to slightly over 350 loans for approximately $500,000. The loan portfolio was reduced during 1976 as a result of a $2 million sale to Sallie Mae. The sale was made at less than par.

### Program Administration

Bank 8 is in a Federal program state. The GSLP staff consists of approximately 7 persons who process loan applications, conversions and perform collections activities. Additional support is provided by operations personnel who perform subsidized and nonsubsidized billing and repayment servicing.

All loans are originated centrally. A personal interview is required for loan origination but not for loan conversion. No external or internal credit checks are

performed. HEW insurance premiums are collected by deducting the insurance amount from the note amount when the disbursement is made. Disbursements are made in the form of a cashiers check payable to the student.

All loans are maintained on an automated system with separate coding structures for interim subsidized, interim nonsubsidized, repayment and claims loans. Interest for both interim and repayment loans is computed on a simple interest basis. Interim unsubsidized and HEW billings are performed manually by operations personnel. Invoices are produced by the system for notes in repayment status.

Status verification is not performed prior to the beginning of the conversion period. Six months prior to conversion, a notice indicating the loan balance and the graduation date is computer generated and sent to the student. Three months after graduation, a second notice is sent. The repayment schedule is sent out three months prior to the scheduled first payment. If it is not returned prior to the date on which the first payment is due, a certified letter is sent, followed by letters to all references and the school. Preclaims assistance is then requested.

If the repayment schedule is returned, loans are consolidated and the loan is transferred to repayment status. Invoices are mailed out monthly to students. During the repayment period, late charges are applied after 10 days delinquency and notices are sent at 20-day intervals up to a letter demanding payment in full which is sent after 90 days of delinquency. After 120 days, a claim is filed with HEW.

Current Attitudes and Plans for Future Participation

Bank 8 is planning to withdraw from the GSLP as current borrowers complete their education. The policy of no loans to any student except current borrowers will eventually reduce the outstandings to zero.

Bank 8 reportedly withdrew from the program for four reasons:

- High delinquency rate;
- Delays in claims settlement;
- Complex regulations; and
- Loss on investment determined by an internal profitability study.

Interviews with student loan management indicate that their decision to withdraw from the program would not be affected by changes in the special allowance.

# V. COST AND REVENUE ANALYSIS

## V. COST AND REVENUE ANALYSIS

As was discussed in Section III, the financial institutions studied were carefully selected to assure that they would be generally representative of a larger group of lenders. In addition, each lender was screened to verify their general compliance with program requirements and the availability of the financial information required. In spite of these measures, the number of differences among bank programs make comparisons among the banks studied difficult. Examples of the differences include the following:

- differences in the organization and placement of the student loan processing staff;
- differences in the level of staffing committed to the student loan portfolio;
- differences in the administrative processes utilized to carry out the program; and
- differences in the characteristics of the student loan portfolio such as the extent to which new loans are being originated.

In spite of these differences, we have arrived at certain overall conclusions concerning the program.

The purpose of this section is to summarize the cost and revenue data collected for the banks studied and to present our analysis of that data. The methodology and assumptions described in Section III are essential to an adequate understanding of the data presented in this section.

We have analyzed the profitability of each student loan portfolio utilizing two approaches. The first approach, using marginal costs, is to assess the profitability of the portfolio including only those costs which would cease were the program discontinued. The second approach, using full costs, is to assess the profitability of the portfolio assuming that it also bears its share of all allocable indirect costs. These two approaches are presented on lines 7 and 10 of the summary exhibits (V-1 and V-2).

The data presented in Exhibit V-1 is based on a cost of funds amount representing interest costs of obtaining funds but not the costs of servicing demand and time deposits. This has the potential impact of overstating the spread for the lenders studied as indicated in Section III. Our analysis of the data utilizing an actual interest cost of funds indicates that the student loan portfolio was profitable in five institutions and operated at a loss in the three remaining institutions studied during 1976.

Most banks do not have significant additional sources of the low cost money which make up a substantial portion of the actual interest cost of funds (demand deposits and passbook savings). To the extent that student loans are not funded from these low cost sources, use of the actual interest cost of funds tends to cause this element of cost to be understated. We have therefore presented a second analysis (Exhibit V-2) using the cost of funds applied by each bank for internal decision-making purposes. In banks where the internal cost of funds was greater than the actual interest cost of funds, this second analysis tends to offset any understatement of cost which exists in Exhibit V-1. As can be seen in Exhibit V-2, four of the eight student loan programs studied operated at a profit during 1976 when their own internal cost of funds is utilized, although two of the programs were only slightly profitable.

The findings presented in Exhibits V-1 and V-2 are for a year during which the cost of funds to each institution (except Bank 8) was relatively low. If one assumed that the relationship of costs and revenue (except for the special allowance) to outstandings were similar in calendar years 1974 - 1976 and that only the cost of funds and the special allowance rate change, the profitability of the student loan program is generally lower for 1974 and 1975. We conducted this analysis for 1974 and 1975 using each bank's actual interest cost of funds for those periods as well as using each bank's internal cost of funds.

The profitability of the student loan portfolio for 1975 based on an actual interest cost of funds is presented in Exhibit V-3. As is illustrated in the exhibit, five of the financial institutions studied would have operated their student loan programs at a profit during that year. Similar analysis for 1974 is presented in Exhibit V-4. During that period, three of the institutions studied would have operated their programs at a profit and two additional institutions would have only broken even. On Exhibits V-3 and V-4, the affect of the changes may be seen by comparing line 6 to line 3.

The profitability of the student loan portfolio for 1975 based on each bank's internal cost of funds is presented in Exhibit V-5. As is illustrated in the exhibit, only three of the institutions would have operated their program at a profit during that year. Similar analysis for 1974 is presented in Exhibit V-6. During that period, only three of the institutions would have operated their program at a profit. The mutual savings bank which operated at a loss in all other analyses, would have broken even in 1974. In three of the other four institutions, losses would have been close to 4% of outstandings for the year.

The student loan program profitability appears to be influenced by the level of staff committed to the program. Staffing has an influence on the profitability of the program because it results

in increased direct labor costs and also because full-time equivalent staffing is the basis for direct expense and overhead allocations. When we analyzed the relationship between student loan staffing and portfolio profitability, we found that the two institutions which provided more than one full-time equivalent staff person per million dollars in outstandings were also two of the least profitable programs. In fact, the only other institution which operated at a loss during 1976 was the mutual savings bank which had an extraordinarily high cost of funds. The results of this analysis are presented in Exhibit V-7.

We have analyzed the relationship of each component of cost to total GSLP costs. As is indicated in Appendix B, the cost of funds was the largest cost in all of the financial institutions studied. Direct costs are normally the next largest category of costs, with direct labor costs generally larger than other direct costs. Bankwide overhead and department administrative overhead, both allocated based on full-time equivalent staffing, are generally the smallest component of total program costs.

In addition to collecting detailed cost information, we have also collected detailed revenue data for each institution studied. Revenue data was generally not tracked separately by the institutions studied. Therefore review of internal accounting system transaction documentation and other source material was required in order to fully document all income earned from the student loan portfolio. We have identified income for calendar year 1976 from the following sources:

- interest billed to HEW for subsidized students;
- interest billed directly to nonsubsidized students;
- interest earned on notes in repayment status;
- payments from HEW for the special allowance for the four quarters in 1976; and
- late charges and other fees.

We also documented interest lost and other losses on the student loan portfolio which were treated as an offset to gross revenue. The revenue earned from the student loan portfolio for each institution visited is presented in Appendix C. The income as a percent of outstandings varies among banks because of differences in portfolio characteristics, differences in late charges, and differences in interest lost.

As is illustrated by the data presented in this section, the profitability of a student loan portfolio is dependent on the characteristics of the financial institution studied and the administrative processes utilized to support the program. In

our analyses presented in this section, three financial institutions were generally more profitable than the other institutions studied. Two of these institutions, Banks 1 and 3, were located in states with state agencies which provide significant and reportedly effective support services. The third bank which was generally more profitable, Bank 5, was a smaller bank which was not in a major city and which had a low cost of funds compared to the other banks studied.

Three financial institutions had student loan portfolios which were generally less profitable in our analyses. Two of these institutions, Banks 6 and 7, had a ratio of student loan staff to outstandings which was significantly greater than the other institutions studied. The third institution which was generally less profitable, Bank 8, was a mutual savings bank with a relatively high cost of funds during the period of our study.

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EXHIBIT V - 1

SUMMARY OF REVENUE AND COST USING ACTUAL INTEREST COST OF FUNDS--1976

| FINANCIAL DATA | Bank 1 Dollars | Bank 1 % of Outstandings | Bank 2 Dollars | Bank 2 % of Outstandings | Bank 3 Dollars | Bank 3 % of Outstandings | Bank 4 Dollars | Bank 4 % of Outstandings | Bank 5 Dollars | Bank 5 % of Outstandings | Bank 6 Dollars | Bank 6 % of Outstandings | Bank 7 Dollars | Bank 7 % of Outstandings | Bank 8 Dollars | Bank 8 % of Outstandings |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Average GSLP Outstandings | $12,891,941 | - | $14,095,515 | - | $ 8,365,002 | - | $ 3,870,127 | - | $ 6,210,680 | - | $27,679,282 | - | $ 2,418,442 | - | $ 21,496,313 | - |
| 2. Net GSLP Revenue 1/ | 1,085,030 | 8.42% | 1,195,168 | 8.48% | 710,766 | 8.49% | 327,041 | 8.45% | 523,941 | 8.43% | 2,305,875 | 8.33% | 206,220 | 8.53% | 956,354 | 8.32% |
| Direct Expenses 2/ | | | | | | | | | | | | | | | | |
| Labor | 78,113 | .61 | 94,990 | .67 | 83,135 | 1.00 | 39,269 | 1.01 | 41,107 | .66 | 534,611 | 1.93 | 41,785 | 1.73 | 116,367 | 1.01 |
| Other | 43,111 | .33 | 71,142 | .51 | 51,225 | .61 | 21,491 | .56 | 16,161 | .26 | 151,490 | 1.09 | 22,685 | .94 | 86,486 | .75 |
| 3. Sub-Total | 121,224 | .94 | 166,132 | 1.18 | 134,611 | 1.61 | 60,760 | 1.57 | 57,270 | 1.21 | 686,101 | 5.21 | 64,470 | 2.67 | 202,853 | 1.76 |
| 4. Cost of Funds 3/ | 469,139 | 3.64 | 611,745 | 4.34 | 331,368 | 4.32 | 161,706 | 4.23 | 276,766 | 3.80 | 1,436,555 | 5.19 | 92,384 | 3.82 | 685,640 | 5.96 |
| 5. Other Cost Items | -0- | - | 122,698 5/ | .87 | 7,877 7/ | .09 | 257 5/ | .01 | -0- | - | -0- | - | -0- | - | 41,877 5/ | .36 |
| 6. Total Direct Expense (Line 3 + Line 4 + Line 5) | 590,563 | 4.58 | 901,175 | 6.39 | 501,856 | 6.02 | 224,723 | 5.94 | 332,036 | 5.01 | 2,124,656 | 8.40 | 156,854 | 6.49 | 930,350 | 8.09 |
| 7. Net Revenue Less Total Direct Expense (Line 2 - Line 6) | 494,467 | 3.83 | 294,013 | 2.09 | 214,910 | 2.57 | 97,318 | 2.51 | 211,827 | 3.40 | (18,781) | (.07) | 49,366 | 2.04 | 26,004 | .23 |
| Indirect Expense 4/ | | | | | | | | | | | | | | | | |
| Administrative | 10,934 | .08 | 23,121 | .16 | 17,252 | .21 | 10,905 | .28 | 20,669 | .33 | 19,026 | .14 | 7,768 | .32 | 15,770 | .14 |
| Bankwide | 36,264 | .28 | 160,565 | 1.14 | 43,265 | .52 | 19,156 | 1.02 | 17,221 | .66 | 171,454 | 1.29 | 50,549 | 2.09 | 147,140 | 1.28 |
| 8. Sub-Total | 47,198 | .37 | 183,686 | 1.30 | 60,517 | .73 | 30,062 | 1.30 | 37,892 | .77 | 210,285 | 1.43 | 58,317 | 2.41 | 162,910 | 1.42 |
| 9. Total Direct and Indirect Expenses (Line 6 + Line 8) | 637,761 | 4.95 | 1,084,861 | 7.70 | 564,273 | 6.75 | 254,961 | 7.23 | 369,208 | 5.78 | 2,535,141 | 9.16 | 215,171 | 8.90 | 1,093,260 | 9.51 |
| 10. Net Revenue Less Total Direct and Indirect Expenses | $ 447,269 | 3.47 | $ 110,327 | .78 | $ 134,493 | 1.85 | $ 67,024 | 1.22 | $ 161,635 | 2.63 | $ (229,266) | (.83) | $ (8,951) | (.37) | $ (136,906) | (1.19) |

1/ Net revenue is determined by adjusting each institution's reported gross revenue to reflect items such as interest not collected and interest lost on claims pending.
2/ As a result of our use of a standard methodology at all banks studied, a number of adjustments were required in the direct costs as reported internally by each bank. Our major categories of direct costs are labor, occupancy, supplies, postage, telephone, and data processing.
3/ Cost of funds is based on actual fund balances and interest paid, without the costs of servicing demand and time deposits.
4/ Bankwide overhead costs are allocated based on full-time equivalent staffing.
5/ Claims denied by guarantor during 1976.
6/ Sale of notes at less than par during 1976.
7/ Claims reimbursed by guarantor at less than 100%

NOTE: COLUMNS MAY NOT ADD TO TOTALS DUE TO ROUNDING

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EXHIBIT V - 2

SUMMARY OF REVENUE AND COST USING INTERNAL COST OF FUNDS-1976

| FINANCIAL DATA | Bank 1 Dollars | Bank 1 % of Outstandings | Bank 2 Dollars | Bank 2 % of Outstandings | Bank 3 Dollars | Bank 3 % of Outstandings | Bank 4 Dollars | Bank 4 % of Outstandings | Bank 5 Dollars | Bank 5 % of Outstandings | Bank 6 Dollars | Bank 6 % of Outstandings | Bank 7 Dollars | Bank 7 % of Outstandings | Bank 8 Dollars | Bank 8 % of Outstandings |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Average GSLP Outstandings | $12,893,961 | - | 264,095,515 | - | $ 8,365,002 | - | $ 3,870,121 | - | $ 6,230,680 | - | $27,679,292 | - | $ 2,410,442 | - | 111,496,313 | - |
| 2. Net GSLP Revenue 1/ | 1,065,010 | 8.62% | 1,195,180 | 0.46% | 718,766 | 8.59% | 327,041 | 8.45% | 523,843 | 8.41% | 2,305,875 | 8.33% | 206,220 | 8.56% | 356,158 | 8.32% |
| Direct Expenses 2/ | | | | | | | | | | | | | | | | |
| Labor | 78,113 | .61 | 94,990 | .04 | 81,385 | 1.00 | 39,269 | 1.01 | 41,107 | .66 | 534,611 | 1.93 | 41,785 | 1.73 | 116,147 | 1.03 |
| Other | 41,111 | .33 | 71,743 | .03 | 5,229 | .06 | 26,491 | .68 | 34,143 | .55 | 353,690 | 1.28 | 22,681 | .94 | 85,506 | .77 |
| 3. Sub-Total | 119,224 | .94 | 166,733 | 1.18 | 86,614 | 1.06 | 65,760 | 1.70 | 75,250 | 1.21 | 888,301 | 3.21 | 64,466 | 2.67 | 202,653 | 1.76 |
| 4. Cost of Funds 3/ | 603,436 | 4.68 | 730,339 | 5.18 | 416,316 | 4.98 | 206,274 | 5.33 | 358,264 | 5.75 | 1,605,398 | 5.80 | 129,626 | 5.36 | 667,480 | 5.98 |
| 5. Other Cost Items | -0- | - | 122,698 4/ | .87 | 7,477 5/ | .09 | 357 6/ | .01 | -0- | - | -0- | - | -0- | - | 41,927 7/ | .38 |
| 6. Total Direct Expense (Line 3 + Line 4 + Line 5) | 724,660 | 5.62 | 1,047,769 | 7.43 | 559,004 | 6.68 | 272,295 | 7.04 | 433,514 | 6.95 | 2,493,699 | 9.01 | 194,098 | 8.03 | 932,190 | 8.11 |
| 7. Net Revenue Less Total Direct Expense (Line 2 - Line 6) | 340,170 | 2.70 | 147,419 | 1.05 | 159,762 | 1.91 | 54,746 | 1.41 | 90,329 | 1.45 | (187,824) | (.68) | 12,122 | .50 | 24,164 | .21 |
| Indirect Expense 8/ | | | | | | | | | | | | | | | | |
| Administrative | 10,814 | .08 | 23,121 | .16 | 17,152 | .21 | 10,908 | .28 | 20,569 | .33 | 19,026 | .16 | 7,768 | .32 | 15,770 | .14 |
| Bankwide | 36,364 | .29 | 160,565 | 1.14 | 43,265 | .52 | 39,356 | 1.02 | 27,543 | .44 | 171,259 | .62 | 50,349 | 2.09 | 147,140 | 1.28 |
| 8. Sub-Total | 47,178 | .37 | 183,686 | 1.30 | 60,417 | .72 | 50,264 | 1.30 | 48,112 | .77 | 210,285 | .76 | 58,117 | 2.41 | 162,910 | 1.42 |
| 9. Total Direct and Indirect Expenses (Line 6 + Line 8) | 771,838 | 5.99 | 1,231,455 | 8.74 | 619,421 | 7.40 | 322,559 | 8.33 | 481,706 | 7.71 | 2,701,984 | 9.77 | 252,415 | 10.44 | 1,095,100 | 9.53 |
| 10. Net Revenue Less Total Direct and Indirect Expenses | $ (33,178) | (.26) | $ (36,287) | (.26) | $ 99,345 | 1.19 | $ 4,682 | .12 | $ (42,177) | (.68) | $ (298,109) | (1.44) | $ (145,171) | (11.91) | $ (138,746) | (11.21) |

1/ Net revenue is determined by adjusting each institution's reported gross revenue to reflect items such as interest not collected on interest lost on claims pending.
2/ As a result of our use of a standard methodology at all banks studied, a number of adjustments were required to the direct costs as reported internally by each bank. Our major categories of direct costs are labor, occupancy, supplies, postage, telephone, and data processing.
3/ Cost of funds is based on each bank's internal cost of funds.
4/ Bankwide overhead costs are allocated based on full-time equivalent staffing.
5/ Claims denied without recourse during 1976.
6/ Sale of notes at less than par during 1976.
7/ Claims reimbursed by guarantor at less than 100%

NOTE: COLUMNS MAY NOT ADD TO TOTALS DUE TO ROUNDING

EXHIBIT V - 3

SPECIAL ANALYSIS USING ACTUAL COST OF
FUNDS AND SPECIAL ALLOWANCE - 1975

| | FINANCIAL DATA | % OF OUTSTANDINGS FOR Bank 1 | Bank 2 | Bank 3 | Bank 4 | Bank 5 | Bank 6 | Bank 7 | Bank 8 |
|---|---|---|---|---|---|---|---|---|---|
| 1. | 1976 Special Allowance | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% |
| 2. | 1976 Actual Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| 3. | Net Revenue Less Total Direct and Indirect Expenses (1976) | 3.47 | .78 | 1.85 | [illegible]22 | 2.63 | (.33) | (.37) | (1.19) |
| 4. | 1975 Special Allowance | 1.97 | 1.97 | 1.97 | [illegible] | 1.97 | 1.97 | 1.97 | 1.97 |
| 5. | 1975 Actual Cost of Funds | 3.89 | 5.35 | 4.70 | 4.71 | [illegible].63 | 5.81 | 4.54 | 6.04 |
| 6. | Net Revenue Less Total Direct and Indirect Expenses (1975) | 3.66 | .21 | 1.91 | 1.18 | 3.24 | (1.01) | (.65) | (.83) |

Line 6 = Line 3 + (Line 4 - Line 1) - (Line 5 - Line 2)

EXHIBIT V - 4

SPECIAL ANALYSIS USING ACTUAL COST OF FUNDS AND SPECIAL ALLOWANCE - 1974

| | FINANCIAL DATA | % OF OUTSTANDINGS | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Bank 1 | Bank 2 | Bank 3 | Bank 4 | Bank 5 | Bank 6 | Bank 7 | Bank 8 |
| 1. | 1976 Special Allowance | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% |
| 2. | 1976 Actual Cost of Funds | 3.64 | 4.34 | 4.32 | 4.23 | 3.80 | 5.19 | 3.82 | 5.96 |
| 3. | Net Revenue Less Total Direct and Indirect Expenses (1976) | 3.47 | .78 | 1.85 | 1.22 | 2.63 | (.83) | (.37) | (1.19) |
| 4. | 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 5. | 1974 Actual Cost of Funds | 4.97 | 7.43 | 5.86 | 6.72 | 3.86 | 8.34 | 6.78 | 6.01 |
| 6. | Net Revenue Less Total Direct and Indirect Expenses (1974) | 3.42 | (1.03) | 1.59 | .01 | 3.85 | (2.70) | (2.05) | .04 |

Line 6 = Line 3 + (Line 4 - Line 1) - (Line 5 - Line 2)

EXHIBIT V - 5

SPECIAL ANALYSIS USING INTERNAL COST
OF FUNDS AND SPECIAL ALLOWANCE - 1975

FINANCIAL DATA

| | % OF OUTSTANDINGS FOR | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Bank 1 | Bank 2 | Bank 3 | Bank 4 | Bank 5 | Bank 6 | Bank 7 | B |
| 1. 1976 Special Allowance | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | |
| 2. 1976 Internal Cost of Funds | 4.68 | 5.38 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | |
| 3. Net Revenue Less Total Direct and Indirect Expenses(1976) | 2.43 | (.26) | 1.19 | .12 | .68 | (1.44) | (1.91) | ( |
| 4. 1975 Special Allowance | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | 1.97 | |
| 5. 1975 Internal Cost of Funds | 4.83 | 6.58 | 5.20 | 6.17 | 5.56 | 7.36 | 6.28 | |
| 6. Net Revenue Less Total Direct and Indirect Expenses(1975) | 2.72 | (1.02) | 1.41 | (.28) | 1.31 | (2.56) | (2.39) | |

Line 6 = Line 3 + (Line 4 - Line 1) - (Line 5 - Line 2)

EXHIBIT V - 6

SPECIAL ANALYSIS USING INTERNAL COST
OF FUNDS AND SPECIAL ALLOWANCE - 1974

| FINANCIAL DATA | % OF OUTSTANDINGS FOR | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Bank 1 | Bank 2 | Bank 3 | Bank 4 | Bank 5 | Bank 6 | Bank 7 | Bank 8 |
| 1. 1976 Special Allowance | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% | 1.53% |
| 2. 1976 Internal Cost of Funds | 4.68 | 5.33 | 4.98 | 5.33 | 5.75 | 5.80 | 5.36 | 5.98 |
| 3. Net Revenue Less Total Direct and Indirect Expenses (1976) | 2.43 | (.26) | 1.19 | .12 | .68 | (1.44) | (1.91) | (1.21) |
| 4. 1974 Special Allowance | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 | 2.81 |
| 5. 1974 Internal Cost of Funds | 5.78 | 10.36 | 6.27 | 8.22 | 5.75 | 9.63 | 10.18 | 6.03 |
| 6. Net Revenue Less Total Direct and Indirect Expenses (1974) | 2.61 | (3.96) | 1.18 | (1.49) | 1.96 | (3.99) | (2.45) | .02 |

Line 6 = Line 3 + (Line 4 - Line 1) - (Line 5 - Line 2)

EXHIBIT V - 7

DIRECT STAFFING OF THE STUDENT LOAN PROGRAM

| BANK | 1976 Outstandings | 1976 Full-Time Equivalent Staffing | 1976 Staffing/ Million Dollars Outstanding | 1976 Spread 1/ |
|---|---|---|---|---|
| Bank 1 | $12,893,941 | 7.03 | .55 | 3.47% |
| Bank 2 | 14,095,515 | 10.84 | .77 | .78 |
| Bank 3 | 8,365,002 | 7.11 | .85 | 1.85 |
| Bank 4 | 3,870,123 | 3.20 | .83 | 1.22 |
| Bank 5 | 6,230,680 | 3.80 | .61 | 2.63 |
| Bank 6 | 27,679,282 | 49.47 | 1.79 | (.83) |
| Bank 7 | 2,418,442 | 3.05 | 1.26 | (.37) |
| Bank 8 | 11,496,313 | 9.40 | .82 | (1.19) |

1/ $\frac{\text{Net Revenue - Total Expenses}}{\text{Average Outstandings}}$ based on actual interest cost of funds







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# VI. MANAGEMENT OF THE STUDENT LOAN PORTFOLIO

## VI. MANAGEMENT OF THE STUDENT LOAN PORTFOLIO

In addition to collecting data on costs and revenue associated with the student loan portfolio, we also assessed the requirements for managing the student loan program. This assessment was based on interviews with bank top management, documentation of portfolio delinquency rates, and documentation of claims volume and settlement experiences. The purpose of this section is to describe our findings concerning the factors in addition to cost and revenue which influence the level of participation in the program.

### A. Outlook of Bank Top Management

All participating lenders were reportedly involved in the student loan program to satisfy social needs. Given this motivation, management generally seemed willing to participate in the program to some extent even if the yield from the student loan portfolio is somewhat less than the yield from other consumer loan portfolios. However, most lenders did not seem willing to accept both a low yield and the administrative problems associated with the program. These administrative problems generally included:

- the need to continually refine operating procedures as a result of changes in regulatory requirements;
- the need to adhere to selected regulatory requirements which are in some instances more complex than the procedures followed in servicing other consumer loan portfolios;
- excessive time delays in the processing of claims on the part of HEW.

These administrative problems reportedly had more influence on lender's willingness to participate in the program than the yield. In fact, most managers advised us that an increase in the special allowance by itself would have little impact on their level of participation in the program as long as the yield remains less than that realized on other consumer loan portfolios (e.g., 10-12%). As a result of the administrative problems, most lenders have taken measures to limit their level of participation in the program.

In the following subsections, we will assess the delinquency and claims settlement experiences of each lender studied. We will also describe the steps taken by selected lenders to limit their level of participation in the student loan program as a result of the administrative concerns identified above.

B. Delinquency Experience

We identified the number of notes delinquent as of December 31, 1976, and their dollar amount. We also aged the delinquent notes based on the number of days since the delinquent payment was due. Our findings for each financial institution are presented in Exhibit VI-1.

As is illustrated in the exhibit, the delinquency rate on student loans is between 6.1% and 28.1% of the student loan outstandings in repayment status for the institutions studied. This rate generally appeared to be higher than the delinquency rate realized by the lenders on other consumer loan portfolios.

Except for Bank 2, which holds a significant number of Federally guaranteed notes, the banks in state guarantee agency states experienced lower delinquency rates than banks in Federal program states.

C. Claims Settlement Experience

All of the lenders studied had claims filed during 1976. We determined the number of claims pending as of December 31, 1976, and their dollar amount. We also aged the claims pending based on the number of days from initial filing to December 31, 1976. Our findings for each financial institution are presented in Exhibit VI-2.

As is illustrated in the exhibit, all lenders studied experienced significant delays in the settlement of claims filed beyond the 30-45 days considered to be reasonable. Claims settlement delays appeared to be more significant in the Federal program states and the bank in a state agency program which also held Federally guaranteed notes. Banks 1 and 3, which are in states with agencies providing services to participating lenders, experienced significantly less delays in claims settlement than the other lenders studied.

Three banks, Banks 2, 6 and 8, experienced higher claims volumes and more lengthy claims settlement delays than the other lenders studied. These three lenders were no longer originating notes for new borrowers in 1976.

D. Limitations on Program Participation

As a result of the administrative problems associated with the student loan program, most of the lenders studied have taken measures to limit their participation in the student loan program. Banks 2, 6, and 8 are planning no new originations except to current borrowers. The other lenders studied are planning to maintain student loan outstandings at generally their current level.

Of the banks studied which continue to originate student loans for new borrowers, a number of techniques are utilized to control the level of student loan outstandings. These techniques include:

- setting an annual budgetary ceiling on new originations and then lending to new borrowers on a "first come, first serve" basis up to the ceiling;
- restricting student loans to bank customers; and
- restricting student loans to residents of the geographic area in which the bank is located.

Given the attitudes of lenders to date with the student loan program, we believe that limitations on the level of involvement in the program will continue in the future. However, reductions in regulatory requirements, as appropriate, and more timely settlement of claims could result in a willingness on the part of participating lenders to increase their level of participation. For example, two of the three lenders who are making no new originations indicated that this policy could be reversed in the future dependent upon their future program experience.

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EXHIBIT VI - 1

DELINQUENCY STATUS AS OF DECEMBER 31, 1976

| AGING OF DELINQUENT [illegible] AS OF DECEMBER 31, 1976 FROM DATE DUE | Bank 1 | | Bank 2 | | Bank 3 | | Bank 4 | | Bank 5 | | Bank 6 | | Bank 7 | | Bank 8 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number of Borrowers | Dollars | Number of Borrowers | Dollars | Number of Borrowers | Dollars | Number of Borrowers | Dollars 1/ | Number of Borrowers | Dollars | Number of Borrowers | Dollars | Number of Borrowers | Dollars | Number of Borrowers | Dollars |
| 31 - 60 Days | 150 | $ 123,193 | 391 | $ 543,759 | [illegible] | $ 141,879 | 43 | $ 109,[illegible] | [illegible] | $ 124,427 | 962 | $1,067,340 | 20 | $ 41,955 | 261 | $ 365,559 |
| 61 - 90 Days | 53 | 86,557 | 174 | 214,996 | 14 | 16,130 | 16 | 43,331 | 80 | 116,012 | 685 2/ | 773,086 2/ | 8 | 14,198 | 162 | 252,002 |
| 91 - 120 Days | 25 | 52,004 | 880 | 1,043,755 | 23 | 17,283 | 7 | 235,8[illegible] | [illegible] | 74,373 | | | 3 | 8,913 | 403 | 595,676 |
| Over 120 Days | 25 | 40,200 | - | - | - | - | - | - | 144 | 195,676 | | | - | - | - | - |
| Total | 253 | $ 501,954 | 1,445 | $1,802,510 | 140 | $ 195,300 | 135 | $ 388,845 | [illegible] | $ 510,088 | 1,654 | $1,840,426 | 31 | $ 65,066 | 826 | $1,213,237 |
| Percent of Outstandings in Repayment Status | | 9.6% | | 28.1% | | 10.5% | | 20.7% | | 14.1% | | 13.0% | | 6.0% | | 14.3% |

1/ Includes unearned interest.
2/ Detail breakdown not available.

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EXHIBIT VI - 2

CLAIMS STATUS AS OF DECEMBER 31, 1976

| AGING OF CLAIMS PENDING ON DECEMBER 31, 1976 FROM DATE OF INITIAL FILING | Bank 1 | | Bank 2 [1] | | Bank 3 | | Bank 4 | | Bank 5 | | Bank 6 | | Bank 7 | | Bank 8 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number of Claims | Dollars | Number of Claims | Dollars | Number of Claims | Dollars [2] | Number of Claims | Dollars | Number of Claims | Dollars [2] | Number of Claims | Dollars | Number of Claims | Dollars | Number of Claims | Dollars [2] |
| Under 3 Months | 11 | $ 27,440 | 369 | $376,260 | 1 | | 12 | $ 32,[illegible] | 3[illegible] | $ [illegible] | 223 | $290,684 | 1 | $ 2,618 | 72 | |
| 4 - 6 Months | 46 | 81,040 | 30 | 33,120 | 2 | | 16 | 43,028 | 1[illegible] | | 42 | 64,019 | 11 | 38,296 | 4 | |
| 7 - 12 Months | - | - | 56 | 60,532 | 1 | | 1 | 6,325 | - | | 17 | 16,141 | - | - | 1 | |
| Over 12 Months | - | - | 91 | 101,634 | - | - | - | - | - | | 12 | 17,147 | 1 | 2,050 | 19 | |
| Total | 57 | $108,480 | 546 | $571,746 | [illegible] | $ [illegible] | 29 | $ 82,[illegible] | 55 | $152,[illegible] | 294 | $387,991 | 13 | $ 42,964 | 96 | $152,363 |
| Percent of Outstandings | | [illegible] | | 4.1 [1] | | .1 | | 2.1 | | 2.5 | | 1.4% | | 1.8% | | 1.3% |

[1] Federal claims only; state claims data breakdown not available.
[2] Data aging the dollars of claims pending not available.

# VII. INCIDENTAL CONCLUSIONS

## VII. INCIDENTAL CONCLUSIONS

Our conclusions related to the data collected are presented in Section V. Based on our visits to the financial institutions studied, we have also arrived at several incidental conclusions concerning the Guaranteed Student Loan Program. These incidental conclusions are generally based on our program knowledge gained during the project rather than on the data collected. These incidental conclusions which are presented for consideration by the Committee are as follows:

1. Special allowance mechanism - the cost of funds represents a significant portion of total costs for each lender studied. Significant increases in fund costs will therefore have a significant impact on the spread between revenue and costs for lenders participating in the student loan program. We believe that Public Law 94-482 has effectively reduced the impact of these increases through linking the computation of the special allowance to the ninety-day Treasury bill rate and raising the special allowance ceiling to 5%.

   On the other hand, there may not be adequate protection during periods of low fund costs for savings institutions which have more constant sources and costs of funds. This was evident in 1976 for the mutual savings bank studied. We believe that a floor on the special allowance should be considered by the Committee in order to retain the participation of these institutions during periods in which the Treasury bill rates are exceptionally low.

2. State guarantee agency services - the costs of portfolio administration appear to be lower and the willingness of lenders to participate appears to be greater in states where a guarantee agency provides effective support activities for participating lenders. These activities include:

   - assistance in interpreting requirements,
   - assistance in tracking the status of students,
   - collections assistance, and
   - prompt claims settlement including payment of interest on all claims upheld.

   We believe that all guarantors should be encouraged to diligently perform support activities such as those identified above. To the extent that such services may

be provided more effectively and efficiently at the state level, the activities underway to establish additional state guarantee agencies should be encouraged.

3. Claims settlement - delays in the settlement of Federal claims was a major concern to most lenders studied. We believe that measures should be taken by the Office of Education to assure settlement of all claims within one to two months from the date of filing. One approach to expedite claims payment would be to pay claims when filed, review the validity of the claim after payment, and deduct the amount of any denied claims from the next quarterly payment to the lender. Control over this process would be necessary to insure that advance payments do not exceed amounts likely to be due to a participating lender.

4. Federal Program Requirements - the process required to administer a guaranteed student loan portfolio is exceedingly complex when compared to the process utilized by most lenders to administer other consumer loans. We believe that the high direct cost rate (up to 3% of outstandings) experienced by the lenders studied may be attributed at least in part to these complex regulatory requirements.

We have observed a number of requirements resulting from the law or the regulations which appear to produce manual recordkeeping or processing requirements for participating lenders. This additional exception processing is likely to increase the cost of participation in the program. A few examples of requirements which result in exception processing include:

- the existence of several different interest rates which may apply to notes for the same borrower, depending on the dates of disbursement;
- requirements which allow some notes for a borrower to be eligible for interest subsidy but other notes for the same borrower to be ineligible;
- collection procedures which differ from those utilized for other consumer loans; and
- documentation requirements more detailed than those followed for other consumer loans.

We believe that the law and the regulations should be reviewed with the objective of identifying and reducing, where feasible, requirements which result in costly exception processing.

5. Proposed Regulations - we discussed the proposed student loan regulations dated November 5, 1976 with each participating lender. Although not all lenders were familiar with the proposed regulations in detail, it was evident that certain requirements would result in significant cost increases to selected lenders. This would occur when a lender is not presently administering the student loan portfolio in full accord with the proposed regulations. Examples of the proposed requirements which would be a concern to selected lenders are as follows:

   - conduct of personal interview during origination;
   - determination of interest using a simple interest method;
   - conduct of periodic status verification for students; and
   - adherence to collection procedures more rigorous than those utilized for other consumer loans.

   We believe that the proposed regulations should be reviewed with the objective of reducing, where feasible, requirements which would result in unwarranted additional costs to participating lenders.

We believe that consideration of the topics discussed above may help to assure the continued role of private financial institutions in the Guaranteed Student Loan Program.

# APPENDICES

# APPENDIX A

# DATA COLLECTION FORMS

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

I. BACKGROUND INFORMATION SUMMARY

1. Institution _____

2. Address _____

3. Contact _____ Title _____

4. Telephone Number _____

5. USOE ID. NO. _____

6. Type of Institution
Commercial Bank___ Mutual Savings Bank___ Savings Association___

7. Guarantors
Federal _____ State Agency _____ Other_____

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN ALLOWANCES

## II. QUESTIONNAIRE FOR GSLP PROGRAM MANAGER

1. DATE GSLP STARTED AT BANK _____
2. WHY DOES BANK OFFER STUDENT LOANS? _____
3. CRITERIA USED BY BANK TO ALLOCATE FUNDS TO GSLP _____

_____

_____

4. GROWTH OF OUTSTANDINGS

| | TOTAL | IN SCHOOL, GRACE OR DEFERRAL | IN REPAYMENT |
|---|---|---|---|
| 12/31/76 | $_____ | $_____ | $_____ |
| 12/31/75 | $_____ | $_____ | $_____ |
| 12/31/74 | $_____ | $_____ | $_____ |
| 12/31/73 | $_____ | $_____ | $_____ |
| 12/31/72 | $_____ | $_____ | $_____ |

5. ORGANIZATIONAL PLACEMENT OF GSLP _____
_____ (Complete Schedule A)
6. GSLP STAFF SIZE (FULL TIME EQUIVALENTS)
   OFFICERS _____
   STAFF _____
   TOTAL _____
7. DESCRIPTION OF STATE GUARANTEE AGENCY REGULATIONS AND TAX LAWS IMPACTING PROGRAM _____

_____

_____

8. DESCRIPTION OF PROGRAM CHANGES DURING CY 76, IF ANY _____

_____

_____

9. ASSESSMENT OF IMPACT OF PROPOSED NOVEMBER 1976 REGULATIONS _____

_____

_____

10. MOST DIFFICULT GSLP REQUIREMENTS TO MEET _____

_____

_____

11. OPPORTUNITIES FOR GSLP IMPROVEMENT _____

_____

_____

12. PLANS FOR FUTURE PARTICIPATION _____

_____

_____

13. COMPARISON OF GSLP TO OTHER LOANS OF SIMILAR MATURITY
    RETURN ON INVESTMENT _____
    PERCEIVED RISK _____
    OTHER _____
14. PROGRAM CHARACTERISTICS (COMPLETE SCHEDULE B)
15. PORTFOLIO CHARACTERISTICS (COMPLETE SCHEDULE C)
16. PROCESS FLOW (COMPLETE SCHEDULE D)

Interviewer_____ Interviewee_____ Date _____

Position_____

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

III. QUESTIONNAIRE FOR FINANCIAL MANAGER

1. BANK FISCAL YEAR _____ (REQUEST MOST RECENT ANNUAL REPORT)

2. TOTAL BANK ASSETS $_____ AS OF 12/31/76

3. TOTAL BANK DEPOSITS $_____ AS OF 12/31/76

4. DEPARTMENTAL EXPENSE REPORTING
YES _____ NO _____

5. INTER-DEPARTMENT COST TRANSFERS
YES _____ NO _____

6. PARTICIPATE IN FEDERAL RESERVE'S FUNCTIONAL COST ANALYSIS
YES _____ NO _____ (IF YES, REQUEST FORMS)

7. MAINTAIN ANY COSTS BY INDIVIDUAL LOANS YES _____ NO _____

8. DESCRIPTION OF CHART OF ACCOUNTS _____

9. TOTAL BANK PERSONNEL (FULL-TIME EQUIVALENTS)
OFFICERS _____ STAFF _____ TOTAL _____

10. BANK SQUARE FEET _____ GSLP SQUARE FEET _____

11. DESCRIPTION OF BANK'S ACCOUNTING FOR INDIRECT COSTS
Allocated to Departments _____

Not Allocated to Departments _____

12. METHOD FOR DETERMINING INTERNAL COST OF FUNDS _____

13. POTENTIAL SOURCES AND COSTS OF ADDITIONAL FUNDS _____

14. DESCRIPTION OF METHOD OF INTEREST BOOKING _____

15. FREQUENCY OF INTEREST BILLING _____

16. BASIS FOR INTEREST COMPUTATION _____

17. IMPACT OF FUTURE CHANGES IN SPECIAL ALLOWANCE ON SUPPLY OF FUNDS TO GSLP _____

18. LABOR COSTS (COMPLETE SCHEDULE E)

19. OTHER DIRECT COSTS (COMPLETE SCHEDULE F)

20. INDIRECT COSTS (COMPLETE SCHEDULE G)

21. COST OF FUNDS (COMPLETE SCHEDULE H)

22. GSLP REVENUE (COMPLETE SCHEDULE I)

Interviewer _____ Interviewee _____ Date _____

Position _____

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE A. BANK ORGANIZATION

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE B. PROGRAM CHARACTERISTICS

1. BANK'S UNIQUE QUALIFYING REQUIREMENTS FOR GSLP _____

2. BRANCH ORIGINATION
   YES ____ NO ____ NUMBER OF BRANCHES _____
   NUMBER ORIGINATING _____

3. PERSONAL INTERVIEW DURING
   APPLICATION YES ____ NO ____
   CONVERSION YES ____ NO ____

4. USE OF CREDIT CHECKS YES ____ NO ____

5. COMPUTE AND COLLECT INSURANCE PREMIUMS?
   YES ____ NO ____

6. DESCRIPTION OF METHOD OF DISBURSEMENT _____

7. USE OF AUTOMATION
   In School Servicing YES ____ NO ____
   Repayment Servicing YES ____ NO ____

8. USE OF SERVICER
   YES ____ NO ____
   If YES, Name of Servicer _____
   Functions Performed _____
   Date Servicing Commenced _____
   Service for GSLP ____ All Loans ____

9. STATUS VERIFICATION CONDUCTED WHILE IN SCHOOL
   YES ____ NO ____ METHOD _____
   FREQUENCY _____

10. SKIP TRACING ACTIVITIES BEFORE CONVERSION TO REPAYMENT
    METHOD _____ FREQUENCY _____

11. WHEN CONVERSION OCCURS, ARE NOTES COMBINED INTO ONE REPAYMENT SCHEDULE? YES _____ NO _____

12. BILLING METHOD
    COUPON BOOK ____ INVOICES ____ OTHER ____

13. PROCESS FOR TREATING PREPAYMENTS AND OVERPAYMENTS _____

14. DELINQUENCY FOLLOW-UP ACTIVITIES
    METHOD _____ FREQUENCY _____

15. USE OF COLLECTION AGENT
    YES ____ NO ____
    If YES, Name of Agent _____
    Functions Performed _____
    Date Agreement Commenced _____

16. COMPUTE INTEREST ADJUSTMENTS PRIOR TO BILLING INTEREST?
    YES ____ NO ____

17. BILL HEW FOR SPECIAL ALLOWANCE? YES ____ NO ____
    If YES, Process for Computing _____

18. ARRANGEMENTS WITH SCHOOLS TO LOAN TO THEIR STUDENTS
    YES _____ NO _____

19. SCHOOLS FREQUENTLY ATTENDED BY BORROWERS _____

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE C. GSLP PORTFOLIO CHARACTERISTICS
(CY 1976)

1. STUDENT LOANS ORIGINATED

| | Principal ($) | Number of Notes |
|---|---|---|
| 1/1-3/31 | | |
| 4/1-6/30 | | |
| 7/1-9/30 | | |
| 10/1-12/31 | | |
| Total | $ | |

2. ESTIMATE OF CY 77 ORIGINATIONS
NUMBER _____ $_____

3. STUDENT LOANS CONVERTED TO REPAYMENT

| | Principal ($) | Number of Notes | Number of Students |
|---|---|---|---|
| 1/1-3/31 | | | |
| 4/1-6/30 | | | |
| 7/1-9/30 | | | |
| 10/1-12/31 | | | |
| Total | | | |

4. ESTIMATE OF CY 77 CONVERSIONS TO REPAYMENT
NUMBER _____ $_____

5. STUDENT LOANS OUTSTANDING (ALL)

| | In School, Grace, or Deferred Principal ($) | Number | In Repayment Principal ($) | Number | Total Principal ($) | Number | Daily Average for Quarter (if Available) |
|---|---|---|---|---|---|---|---|
| As of 12/31/75 | | | | | | | - |
| As of 3/31/76 | | | | | | | |
| As of 6/30/76 | | | | | | | |
| As of 9/30/76 | | | | | | | |
| As of 12/31/76 | | | | | | | |

ANNUAL AVERAGE

6. NOTES IN PORTFOLIO ORIGINATED BEFORE 1973
Number _____ $ _____

7. STUDENT LOANS PURCHASED IN CY 76

| | | Interim | Repayment | |
|---|---|---|---|---|
| DATES _____ | AMOUNT | $_____ | $_____ | FROM _____ |
| _____ | | _____ | _____ | _____ |
| _____ | | _____ | _____ | _____ |

8. STUDENT LOANS SOLD IN CY 76

| | | Interim | Repayment | |
|---|---|---|---|---|
| DATES _____ | AMOUNT | $_____ | $_____ | TO _____ |
| _____ | | _____ | _____ | _____ |
| _____ | | _____ | _____ | _____ |

9. CLAIMS STATUS FOR CY 76

| | Number | Amount | CLAIMS AGING FROM INITIAL FILING (months) 1-3 | 4-6 | 7-12 | over 12 |
|---|---|---|---|---|---|---|
| Filed | | $ | | | | |
| Allowed | | $ | | | | |
| Denied | | $ | | | | |
| Pending 12/31 | | $ | | | | |

10. DELINQUENCY STATUS AS OF 12/31/76

| | 31-60 days | 61-90 days | 91-120 days | Over 120 days | Total |
|---|---|---|---|---|---|
| Principal | | | | | |
| Number of Borrowers | | | | | |

11. UNSUBSIDIZED STUDENT LOANS

| | |
|---|---|
| Number Outstanding 1/1/76 | |
| Principal Outstanding 1/1/76 | $_____ |
| Number Originated CY 76 | |
| Principal Originated CY 76 | $_____ |
| Number Converted to Repayment CY 76 | |
| Principal Converted to Repayment CY 76 | $_____ |
| Number Outstanding 12/31/76 | |
| Principal Outstanding 12/31/76 | $_____ |

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE D. GSLP PROCESS FLOW

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE E. DIRECT LABOR COST

| DIVISION | PERSONNEL | TOTAL COMPENSATION | | | % OF TIME BY FUNCTION | | | | | | ALLOCATION OF COMPENSATION BY FUNCTION | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | SALARY | FRINGES | TOTAL | ORIGINATION | IN-SCHOOL SERVICING | CONVERSION TO REPAYMENT | REPAYMENT | COLLECTION | TOTAL | ORIGINATION | IN-SCHOOL SERVICING | CONVERSION TO REPAYMENT | REPAYMENT | COLLECTION | TOTAL |





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GUARANTEED STUDENT [illegible] PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE F. OTHER DIRECT COSTS

| DIRECT COST COMPONENT | TOTAL COST | % TO GSLP | GSLP COST | DISTRIBUTED BY GSLP FUNCTION ($) ORIGINATION | IN-SCHOOL SERVICING | CONVERSION TO REPAYMENT | REPAYMENT | COLLECTION | BASIS FOR ALLOCATION TO GSLP | BASIS FOR DISTRIBUTION AMONG GSLP FUNCTIONS |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. FURNITURE AND EQUIPMENT | | | | | | | | | | |
| 2. PRINTING, STATIONARY, SUPPLIES | | | | | | | | | | |
| 3. POSTAGE, DELIVERY | | | | | | | | | | |
| 4. TELEPHONE, TELEGRAPH | | | | | | | | | | |
| 5. DIRECT CONTRIBUTION OF OTHER DEPARTMENTS: COMPUTER SERVICE | | | | | | | | | | |
| 6. OTHER DIRECT COSTS: | | | | | | | | | | |
| TOTAL | | | | | | | | | | |





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GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE G. INDIRECT COSTS

| INDIRECT COST COMPONENT | TOTAL COST | % TO GSLP | GSLP COST | DISTRIBUTED BY FUNCTION ($) | | | | | BASIS FOR ALLOCATION TO GSLP | BASIS FOR DISTRIBUTION AMONG GSLP FUNCTIONS |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | ORIGINATION | IN-SCHOOL SERVICING | CONVERSION TO REPAYMENT | REPAYMENT | COLLECTION | | |
| 1. OCCUPANCY/SPACE | | | | | | | | | | |
| 2. DEPARTMENT OVERHEAD | | | | | | | | | | |
| 3. BANK-WIDE OVERHEAD: | | | | | | | | | | |
| EXECUTIVE SALARIES | | | | | | | | | | |
| EXECUTIVE SPACE | | | | | | | | | | |
| BANK SERVICES | | | | | | | | | | |
| ACCOUNTING | | | | | | | | | | |
| PERSONNEL/PAYROLL | | | | | | | | | | |
| 4. OTHER INDIRECT COSTS: | | | | | | | | | | |
| TOTAL | | | | | | | | | | |





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GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE H. COST OF FUNDS

1. INTERNAL COST OF FUNDS USED BY BANK

| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | ANNUAL AVERAGE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CY 76 | | | | | | | | | | | | | |
| CY 75 | | | | | | | | | | | | | |
| CY 74 | | | | | | | | | | | | | |

2. COMPUTED COST OF FUNDS BY SOURCE FOR CY 76:

| | CY 76 | | CY 75 | | CY74 | |
|---|---|---|---|---|---|---|
| | AMOUNT | AVERAGE INTEREST | AMOUNT | AVERAGE INTEREST | AMOUNT | AVERAGE INTEREST |
| FEDERAL FUNDS PURCHASED | | | | | | |
| FUNDS BORROWED FROM SALLIE MAE | | | | | | |
| CAPITAL NOTES | | | | | | |
| DEMAND DEPOSITS (AVERAGE DAILY) | | | | | | |
| TIME DEPOSITS (AVERAGE DAILY) | | | | | | |
| OTHER: | | | | | | |
| TOTAL | $ | | $ | | $ | |
| WEIGHTED AVERAGE INTEREST | | % | | % | | % |

3. INTEREST RATE ON LAST CERTIFICATE OF DEPOSIT OVER $100,000 SOLD BY PERIOD

| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| AMOUNT ($) | | | | | | | | | | | | |
| INTEREST (%) | | | | | | | | | | | | |

NOTE: Request Banks 10K Statement As Required

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GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE I. GSLP REVENUE (CY 1976)

| | 1/1-3/31 | 4/1-6/30 | 7/1-9/30 | 10/1-12/31 | Total |
|---|---|---|---|---|---|
| 1. AVERAGE OUTSTANDING (Schedule C, line 5) | | | | | |
| 2. INTEREST BILLED TO HEW FOR SUBSIDIZED STUDENTS | | | | | |
| 3. INTEREST BILLED TO NON-SUBSIDIZED STUDENTS IN SCHOOL | | | | | |
| 4. INTEREST EARNED ON NOTES IN REPAYMENT | | | | | |
| 5. SPECIAL ALLOWANCE BILLED TO HEW | | | | | |
| 6. LATE CHARGES | | | | | |
| 7. ALL OTHER GSLP REVENUE | | | | | |
| 8. GROSS GSLP REVENUE | | | | | |
| 9. LESS: INTEREST NOT COLLECTED | | | | | |
| 10. LESS: CLAIMS DENIED | | | | | |
| 11. NET GSLP REVENUE | | | | | |
| 12. YIELD (%) | | | | | |

GUARANTEED STUDENT LOAN PROGRAM
COMMITTEE ON THE PROCESS OF DETERMINING
STUDENT LOAN SPECIAL ALLOWANCES

SCHEDULE J. SUMMARY OF DATA
(CY 76)

| | $ | % OF AVERAGE OUTSTANDINGS |
|---|---|---|
| 1. AVERAGE OUTSTANDING (SCHEDULE C, line 5 | | — |
| 2. NET GSLP REVENUE (SCHEDULE I, line 11) | | |
| 3. OPERATING EXPENSE | | |
| LABOR COSTS (TOTAL, SCHEDULE E) | | |
| OTHER DIRECT COSTS (TOTAL, SCHEDULE F) | | |
| Sub-Total | | |
| 4. COST OF FUNDS (SCHEDULE H, line 2) | | |
| 5. TOTAL DIRECT EXPENSES | | |
| 6. SPREAD (MARGINAL COST APPROACH) | | % |
| 7. INDIRECT COSTS (TOTAL, SCHEDULE G) | | |
| 8. SPREAD (FULLY ABSORBED COST APPROACH) | | % |

# APPENDIX B

# TOTAL COSTS BY CATEGORY

APPENDIX B

TOTAL COSTS BY COST CATEGORY-1976

| CATEGORY OF COST | Bank 1 Cost | Bank 1 % of Total | Bank 2 Cost | Bank 2 % of Total | Bank 3 Cost | Bank 3 % of Total | Bank 4 Cost | Bank 4 % of Total | Bank 5 Cost | Bank 5 % of Total | Bank 6 Cost | Bank 6 % of Total | Bank 7 Cost | Bank 7 % of Total | Bank 8 Cost | Bank 8 % of Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Direct Cost | | | | | | | | | | | | | | | | |
| Labor | $ 78,113 | 12.25% | $ 94,990 | 8.76% | $ 83,385 | 14.78% | $ 39,269 | 14.03% | $ 31,107 | 11.41% | $ 534,611 | 21.09% | $ 41,785 | 19.42% | $ 119,347 | 18.83% |
| Occupancy | 11,920 | 1.87 | 17,385 | 1.60 | 8,975 | 1.59 | 6,615 | 2.36 | 15,796 | 5.80 | 56,353 | 2.22 | 6,929 | 3.22 | 15,962 | 1.46 |
| Supplies | 4,248 | .67 | 4,863 | .45 | 14,109 | 2.50 | 1,076 | .38 | 920 | .26 | 7,715 | .30 | 1,990 | .92 | 9,706 | .89 |
| Postage | 3,719 | .58 | 6,722 | .62 | 5,120 | .91 | 1,440 | .51 | 1,743 | .48 | 14,838 | .59 | 2,445 | 1.14 | 8,869 | .81 |
| Telephone | 6,045 | .95 | 6,533 | .60 | 4,155 | .74 | 1,340 | .49 | 1,442 | .40 | 34,782 | 1.37 | 2,999 | 1.39 | 8,512 | .78 |
| Data Processing | 5,750 | 1.53 | 25,179 | 2.32 | 12,156 | 2.15 | 12,708 | 4.54 | 5,839 | 1.62 | 206,719 | 8.15 | 4,946 | 2.30 | 30,990 | 2.83 |
| Other | 7,447 | 1.16 | 11,070 | 1.03 | 6,711 | 1.19 | 3,812 | 1.38 | 3,463 | 1.22 | 31,261 | 1.31 | 1,376 | 1.57 | 10,447 | .96 |
| Sub-Total | $ 121,224 | 19.01% | $ 166,742 | 15.37% | $ 134,611 | 23.86% | $ 69,740 | 23.49% | $ 75,250 | 20.09% | $ 888,301 | 35.04% | $ 64,470 | 29.96% | $ 202,833 | 18.55% |
| Cost of Funds 1/ | $ 469,319 | 73.59% | $ 611,745 | 56.39% | $ 361,360 | 64.04% | $ 161,706 | 58.47% | $ 236,766 | 65.73% | $1,436,555 | 56.67% | $ 92,384 | 42.94% | $ 685,840 | 62.72% |
| Indirect Costs | | | | | | | | | | | | | | | | |
| Administrative Overhead | 10,834 | 1.70 | 23,121 | 2.13 | 17,152 | 3.04 | 10,308 | 3.90 | 20,669 | 5.74 | 39,026 | 1.54 | 7,768 | 3.61 | 15,770 | 1.44 |
| Bankwide Overhead | 36,364 | 5.70 | 160,565 | 14.80 | 43,693 | 7.67 | 39,130 | 14.06 | 27,523 | 7.64 | 171,259 | 6.76 | 50,543 | 23.49 | 147,140 | 13.46 |
| Sub-Total | $ 47,198 | 7.40% | $ 183,686 | 16.93% | $ 60,845 | 10.71% | $ 50,261 | 17.95% | $ 48,192 | 13.38% | $ 210,285 | 8.29% | $ 58,311 | 27.10% | $ 162,910 | 14.90% |
| Other Cost Items | - | - | $ 122,698 2/ | 11.31% | 7,877 | 1.40 | $ 217 3/ | 09 | - | - | - | - | - | - | $ 41,877 4/ | 3.83% |
| Total Costs | $ 637,741 | 100.00% | $1,084,871 | 100.00% | $ 564,273 | 100.00% | $ 279,967 | 100.00% | $ 360,208 | 100.00% | $2,535,141 | 100.00% | $ 215,171 | 100.00% | $1,093,260 | 100.00% |

1/ Actual cost of funds based on actual fund balances and interest paid.
2/ Claims denied by guarantor during 1976.
3/ Loss on sale of notes.
4/ Charge off due to reimbursement on claims at 90% by state.

NOTE: COLUMNS MAY NOT ADD TO TOTALS DUE TO ROUNDING

# APPENDIX C

## TOTAL REVENUE BY SOURCE

APPENDIX C

TOTAL REVENUE BY SOURCE - 1974

| SOURCE OF REVENUE | Bank 1 Revenue | Bank 1 % of Outstandings | Bank 2 Revenue | Bank 2 % of Outstandings | Bank 3 Revenue | Bank 3 % of Outstandings | Bank 4 Revenue | Bank 4 % of Outstandings | Bank 5 Revenue | Bank 5 % of Outstandings | Bank 6 Revenue | Bank 6 % of Outstandings | Bank 7 Revenue | Bank 7 % of Outstandings | Bank 8 Revenue | Bank 8 % of Outstandings |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Interest Billed To HEW For Subsidized Students | $ 49[illegible] | 1.79 | [illegible] | [illegible] | $ [illegible] | [illegible] | $ [illegible] | 2.[illegible] | $ [illegible] | 2.[illegible] | | | | | $ 70,249 | 2.90% | $ 191,070 | 1.58% |
| Interest Billed To Non-Subsidized Students | 07,340 | .52 | 999,579 [3] | 1.09 [4] | [illegible],142 | .[illegible] | [illegible],92[illegible] | .[illegible] | [illegible] [3] | .[illegible] | | | | | 37,798 | 1.5% | 11,049 | .10 |
| Interest Earned From Notes In Repayment Status | [illegible],[illegible] | 2.05 | | [5] | 137,412 | 1.[illegible] | 131,[illegible] | 1.41 | 21[illegible],[illegible] | 1.[illegible] | $2,314,572 [6] | 8.96% [6] | | | 63,693 | 2.63 | 169,910 | 1.48 |
| Special Allowance | [illegible],[illegible] | [illegible].39 | 169,213 | 1.20 | 125,[illegible]12 | 1.[illegible]0 | [illegible]2,[illegible]51 | [illegible].[illegible]2 | [illegible]4,[illegible]1[illegible] | 1.[illegible]2 | | | | | 32,721 | 1.35 | 593,093 | 5.26 |
| Late Charges | [illegible],[illegible]14 | .07 | 24,[illegible]98 | .[illegible]9 | [illegible],[illegible]5[illegible] | .05 | [illegible],[illegible]87 | .[illegible] | [illegible],[illegible]4[illegible] | .[illegible] | | | | | 1,759 | .07 | 21,616 | .19 |
| Other Revenue | - | - | - | - | 242 [1] | - | - | - | - | - | - | - | | | - | - | - | - |
| Less: Interest Not Collected | - | - | - | - | [illegible],[illegible]63 | [illegible].[illegible]0[illegible] | [illegible].[illegible]4[illegible] | - | - | - | [illegible],647] | (.03) | | | - | - | - | - |
| Less: Interest Lost on Claims Pending | - | - | - | - | - | - | [illegible],[illegible]4[illegible] | [illegible].[illegible]4[illegible] | [illegible],[illegible]5[illegible] | [illegible].14] | - | - | | | - | - | (20,384) | [illegible].18] |
| Less: Other | - | - | - | - | - | - | [illegible],[illegible]94] [2] | [illegible].[illegible]3] | - | - | - | - | | | - | - | - | - |
| Net Student Loan Program Revenue | [illegible],[illegible]2[illegible] | 8.43% | [illegible],[illegible]2[illegible] | 4.28 | $ [illegible],[illegible]1[illegible] | [illegible].[illegible]8 | $ [illegible],[illegible]2[illegible] | [illegible].[illegible]1 | $ [illegible],[illegible]4[illegible] | [illegible].41 | [illegible],[illegible]7[illegible] | 9.11% | | | $ 2[illegible],[illegible]2[illegible] | 8.53% | $ [illegible],[illegible]5[illegible] | 8.32% |

[1] Extension fees.
[2] Adjustment required to special allowance billing.
[3] Accrued interest treated as income although not billed.
[4] Detail breakdown not available.

NOTE: COLUMNS MAY NOT ADD TO TOTALS DUE TO ROUNDING

APPENDIX B

INSTITUTIONS SURVEYED BY THE COMMITTEE

## FINANCIAL

State Bankers Associations (50)

Mr. Louis H. Nevins
Director-Counsel
National Association of Mutual
Savings Banks
1709 New York Avenue, N. W.
Washington, D. C. 20006

Mr. Robert Jaynes
Installment Lending Division
American Bankers Association
1120 Connecticut Ave., N. W.
Washington, D. C. 20036

Mr. Anthony Maxwell
Executive Director
National Bankers Association
490 L'Enfant Plaza East, S.W.
Suite 3204
Washington, D. C. 20024

Mr. Joseph Salm
Assistant Vice President
U. S. League of Savings Assoc.
111 East Wacker Dirve
Chicago, Illinois 60601

Mr. Glenn Swanson
Washington Office Manager
Independent Bankers Association
1625 Massachusetts Ave., N.W.
Room 203
Washington, D. C. 20036

Mr. Jonathan Lindley
Managing Director
Washington Office
Credit Union National Assoc.
1730 Rhode Island Ave., N. W.
Suite 810
Washington, D. C. 20036

Miss Peggy Goldsmith
Administrative Vice President
Consumer Bankers Association
1725 K Street, N.W.
Washington, D. C. 20006

## EDUCATIONAL

Mr. John Phillips
President, National Association
of Independent Colleges and
Universities
1717 Massachusetts Ave., N. W.
Suite 503
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Dr. Carol Van Alstyne
Chief Economist, Economics
and Finance Unit
American Council on Education
One Dupont Circle
8th Floor
Washington, D. C. 20036

Mr. Richard Ramsden
Executive Director
Consortium on Financing
Higher Education
Post Office Box 251
Hanover, New Hampshire 03755

Byron T. Collins, S.J.
Special Assistant for
Federal Relations
Georgetown University
Washington, D. C. 20007

Ms. Lois D. Rice
Vice President and Director
of the Washington Office
College Entrance Examination Board
1717 Massachusetts Avenue, N. W.
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Mr. Peter Muirhead
Director, ERIC/Higher Education
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Mr. Edwin P. Adkins
Associate Vice President
American Association of Colleges
for Teacher Education
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Washington, D. C. 20036

Dr. George Weathersby
Harvard University
School of Education
Gutman 450
Cambridge, Massachusetts 02138

Dr. John Tirrell
Vice President for
Governmental Affairs
American Association of Community
and Junior Colleges
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Washington, D. C. 20036

Dr. Jay Stampen
American Association of State
Colleges and Universities
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Ms. Susan Fratkin
Director, Special Programs
National Association of State
and Land Grant Colleges
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Director
National Institute of Education
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Washington, D. C. 20208

Dr. Dyckman Vermilye
American Association for
Higher Education
One Dupont Circle, N. W.
Washignton, D. C. 20036

Mr. Fred Ness
President
Association of American Colleges
1818 R Street, N. W.
Washington, D. C. 20009

Mr. Richard Fulton
Executive Director
Association of Independent
Colleges and Schools
1730 M Street, N. W.
Washington, D. C. 20036

Mr. William Goddard
Executive Director
National Association of
Trade & Technical Schools
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Washington, D. C. 20036

Mr. Robert F. Corcoran
Associate Director
Education Commission of the States
1860 Lincoln Tower
Denver, Colorado 80203

Mr. Joseph P. Kane
Legislative Consultant
National Catholic Education
Association
One Dupont Circle, N. W.
Washington, D. C. 20036

Executive Secretary
National Association of Student
Financial Aid Administrators
910 17th Street, N. W. #228
Washington, D. C. 20006

Mr. Harold Buckingham
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Rapid City, South Dakota 57701

Mr. Allan W. Purdy
Director
Student Financial Aid Services
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306 Clark Hall
Columbia, Missouri 65201

Mr. G. Richard Wynn
Vice President for
Business Affairs
Earlham College
National Road West
Richmond, Indiana 47374

Mr. Kurt Hertzfeld
Treasurer
Amherst College
P. O. Box 10, Station 2
Amherst, Massachusetts 01002

Treasurer and Controller
ITT Educational Services
3750 Guion Road
Fourth Floor
Indianapolis, Indiana 46222

Mr. Francis Finn
National Association of College &
University Business Officers
One Dupont Circle
Washington, D. C. 20036

## STUDENT ASSOCIATIONS

Mr. Arthur Rodbell
Executive Director
National Student Lobby
2000 P Street, N. W.
Suite 515
Washington, D. C. 20036

Ms. Felice Smith
c/o U. C. Student Lobby
926 J Street
Room 522
Sacramento, California 95814

Mr. Joseph Packer
Student Association
109 State Street
Albany, New York 12207

Mr. Thomas Cavanaugh
267 Orange Street
New Haven, Connecticut 06510

Mr. Douglas Veihland
Executive Director
Associated Students of Missouri
606 Maryland Avenue
Columbia, Missouri 65201

Ms. Marci Reddick
Indiana Student Association
IMU Room 22
Indiana University
Bloomington, Indiana 47401

Mattie Smith
Upward Bound Project
Marquette University
Milwaukee, Wisconsin 53233

Ms. Lee Ingalls
106 E. Columbia
Colorado Springs, Colorado 80907

Mr. Clark Jobe
1115 West 10th Street
Austin, Texas 78703

Mr. Michael Vorhaus
Box 1007
Weslyan Station
Middletown, Connecticut 06457

Mr. Arturo Schavez
Educational Opportunity Program
California State University
of Los Angeles
515 State University Drive
Los Angeles, California 90036

Mr. Ed Martin
Student Government Office
University of Houston
Houston, Texas 77004

GOVERNMENTAL & OTHER

Guarantee State Agencies (26)*
United Student Aid Funds, Inc.

* Guarantee Agencies solicited comments from educational and financial institutions in their respective states.

## APPENDIX C

## SELECTED COMMENTS FROM RESPONDENTS REGARDING THE SPECIAL ALLOWANCE

National Association of Student Financial Aid Administrators
Dallas Martin, Executive Secretary

"...of larger concern to our members and certainly to lenders participating in the program is the question regarding assurance. ...very few lenders are willing to expend substantial amounts of capital for the program if they can only be guaranteed a 7% rate of return. The existing law, however, governing the special allowances ranges from 0% to 5% effective October of 1977. This provision, therefore, does not provide the kind of guaranteed floor of assurance which most lenders seek in determining their level of participation in the program. While we realize that economic conditions in the past few years have generated a yield to lenders in excess of 7%, they still have no assurance that this will occur. If such an assurance cannot be given with a firm guarantee, then we believe that lenders will be hesitant to participate in the program to the same degree as they would with some percentage of assurance above 7%."

Danvers Savings Bank, Danvers, Massachusetts
Donald E. Gates, Assistant Treasurer

"...the amendments passed by congress...were looked upon very favorably by this institution and encouraged our continued participation in the program."

Pittsburgh National Bank, Pittsburgh, Pennsylvania
William J. Beran, Community Loan Officer

"The second quarter 1977 Treasury reduction in the amount of 91-day Treasury Bills at a time when the demand for Bills was extraordinarily high resulted in a 91-day Bill average below the bank's marginal cost of funds. If further studies are being undertaken, we would like to suggest that the Special Allowance be tied to the higher of the 91-day Treasury Bill Rate or the Federal Funds Rate which is published weekly by the Federal Reserve."

The Philadelphia Savings Fund Society, Philadelphia, Pennsylvania
Leonard T. Ebert, Vice Chairman

"In order to maintain a flow of funds into guaranteed student loans, the yield or rate of return must reflect the cost of acquiring and servicing the portfolio and provide a net return competitive with alternative investments of similar maturity. It does not seem realistic that the special allowance (which is the primary source of the net return) be determined by the yield on 91-day Treasury Bills. It would seem far more equitable to relate the special allowance formula to the yield index for longer term government obligations...."

Society for Savings, Hartford, Connecticut
Otto W. Rudolph, Vice President

"It is most difficult to comment on the recently contrived basis of 3½% below the average 91-day Treasury Bill rate, primarily due to inexperience with something new.... I can foresee the time ahead where we may, from time to time, withdraw from the activity when the total yield, because of a decline in the supplementary, may be unfavorable and uncertain."

Willimantic Savings Institute, Willimantic, Connecticut
Alexander F. Fabian, Jr., Assistant Treasurer

"We believe tying the special allowance to the T-bill average should work out well and are also pleased that all loans will now be eligible for special allowance...."

American Savings Bank, New Britain, Connecticut
M. William Slade, Jr., Assistant Vice President and
Installment Loan Manager

"By gearing the allowance to the average 91 day treasury bill, we can be assured that the special allowance fee will be based on an accurate reflection of money costs in the current market."

Northwestern University, Evanston, Illinois
William I. Ihlanfeldt, Dean of Admissions, Financial Aid
and Student Records

"Increasingly, the Guaranteed Student Loan Program is becoming the primary financial aid resource at high tuition independent institutions. This is particularly true at the graduate and professional school level where other forms of financial assistance are virtually nonexistent. Loan certainty in contrast to loan availability continues to be a problem as students approach financial institutions. However, the change in the Educational Amendments of 1976 which ties the special allowance to 91-day Treasury Bills is perceived as desirable by most lenders because of its predictability. Further, because of this predictability, educational lenders can monitor their administrative costs to not exceed the rate of return offered through the various secondary market options of Sallie Mae."

Ware Savings Bank, Ware, Massachusetts
Douglas A. Gherlone, Personal Loan Officer

"At the present time, we have adopted a "Wait and See" attitude in regards to the new method of determining the special allowance for student loans. Quite frankly, we have a feeling that this type of allowance is more conducive to commercial banking than to savings banking in general."

City Federal Savings and Loan Association, Elizabeth, New Jersey
Alfred J. Hedden, Executive Vice President

"If the private sector is to continue its participation in the GSLP, it is important that lenders receive a fair yield on the money invested in the program....We feel very strongly that the benchmark to which the subsidy is keyed should be continually reviewed — and reviewed with an eye to allow lenders a guaranteed yield they can live with and which is comparable to yields obtained on other types of loans for the funds invested therein...."

State of Vermont Student Assistance Corporation
Mrs. Paula B. Reeder, Assistant Director, Loan Guarantee Division
re: First Vermont Bank and Trust Company, Brattleboro, Vermont

"....It is my understanding that bank management has been thinking about increasing its commitment to student loans and as such, any indication of improved earnings would provide impetus to their increased participation..."

Valley National Bank, Phoenix, Arizona
Grady Silverthorne, Assistant Vice President

"...the bonus rate must have a realistic floor established...or be based on longer term money market rates to make a positive impact on Student Loan lenders."

The Consumer Bankers Association, Washington, D. C.
Mason G. Alexander, President

"...This formula (91-day Treasury bill rate) is not at all generous and does not provide any motivation for banks to invest in student loans....The Consumer Bankers Association strongly urges the Committee to tie the special allowance to some instrument other than the 91 day Treasury bill rate and that a fee be paid to book a loan."

Consortium on Financing Higher Education, Hanover, New Hampshire
Richard J. Ramsden, Executive Director

"A reasonable rate of return to GSLP lenders provided through a well structured special allowance will encourage lenders to continue their student loan activity. Access to student loans increases the educational choices available to the student and will likewise increase the degree of confidence that the student or his family have in their ability to meet educational costs."

Massachusetts Higher Education Assistance Corporation,
Boston, Massachusetts
Helge Holst, President

"It appears to us quite clear that a change in the level of special allowance provided to GSLPs is required if the program is to continue to receive widespread support. A change in this direction is urgent if this year is not to produce a major crisis for students, parents, and schools."

Freedom Federal Savings and Loan Association, Worcester, Mass.
Douglas W. Abel, Jr., Vice President

"...It is impossible for us to operate our student loan department at a break-even point with the current special allowance. I would like to point out to you that a savings and loan association does not have as broad a lending base as either a commercial or a mutual savings bank. We therefore cannot afford to have lending programs that do not pay their own way...."

United Student Aid Funds, New York, New York
J. Wilmer Mirandon, President

"My main contention is that the government should permit adequate rewards for the participation of private banking, a minimum special interest allowance of 1½%, a portion of which will be returned to the government as tax revenue in any event."

BayBank Norfolk County Trust Company, Dedham, Massachusetts
Edward R. Piana, Senior Vice President

"Student loans definitely are far more difficult credit problems than the conventional debt consolidation loans. The loans are granted without benefit of standard criteria; there is no collateral; no repayment for years; there are substantial changes in conditions and attitudes which occur between inception and graduation for a significant number of loan recipients."

First Vermont Bank and Trust Company, Brattleboro, Vermont
Neal G. Templeton, Vice President

"Our Bank feels that we should have a minimum net income of 2% in any loan portfolio....In reviewing the possible yields for special allowance under the new formula, only 12 quarters out of the last 30 would have resulted in equaling or exceeding our minimum yield."

Associated Students of the University of California
Student Lobby, Sacramento, California

"The fact that the interest assured under student loans does not compete with the prime rate, coupled with the rate of defaults has led a majority of banks to withdraw from the program—substantially reducing the number of loans available to California students. As you are aware, the situation is critical...."

Virginia State Education Assistance Authority, Richmond, Virginia
Charles W. Hill, Director

"The new method for calculating the special allowance is so much of an improvement over the previous method that we hesitate to tamper with it. We, therefore, have no particular suggestions for matters to be considered by the special allowance committee."

APPENDIX D

Actual Special Allowance Payments
vs.
Payments for Theoretical Floor Rates
and Minimum Annual Returns Payments on Loans Made
August 1, 1969 through December 31, 1976

| | Calendar Quarter | Special Allowance Rate | $ of S/A[1] Interest Paid (cash basis) | Average Balance[3] of Loans on Which S/A Was Paid | Theoretical Floor to Total Return on Student Loans 8% Additional Special Allowance | Theoretical Floor to Total Return on Student Loans 8% Additional $ Payment (cash basis)[6] | Theoretical Minimum Annual Average Return 8% Additional Special Allowance | Theoretical Minimum Annual Average Return 8% Additional $ Payment (cash basis)[7] |
|---|---|---|---|---|---|---|---|---|
| 1969 | 3 | 2 % | | $ 180,996,733[4] | | | | |
| | 4 | 2.25 | | | | | 0 | 0 |
| 1970 | 1 | 2 | $ 1,669,137[2] | 639,597,156 | | | | |
| | 2 | 2.25 | 3,224,660 | 704,918,305 | | | | |
| | 3 | 2 | 3,954,302 | 876,219,198 | | | | |
| | 4 | 1.5 | 4,417,105 | 1,313,625,214 | | | 0 | |
| 1971 | 1 | 1 | 4,966,583 | 1,377,124,317 | | | | |
| | 2 | 1.25 | 3,395,649 | 1,535,530,774 | | | | |
| | 3 | 1.25 | 4,785,387 | 1,701,546,526 | | | | |
| | 4 | .75 | 5,361,037 | 2,058,073,660 | .25% | | 0 | |
| 1972 | 1 | .75 | 3,890,605 | 2,233,498,242 | .25 | $ 1,296,868 | | |
| | 2 | .75 | 4,164,925 | 2,502,285,960 | .25 | 1,388,308 | | |
| | 3 | .75 | 4,666,148 | 2,486,446,991 | .25 | 1,555,383 | | |
| | 4 | .75 | 4,687,564 | 2,953,249,756 | .25 | 1,562,521 | .25% | |
| 1973 | 1 | 1 | 5,567,602 | 3,101,432,578 | | 1,855,867 | | $ 6,362,080 |
| | 2 | 1.75 | 7,647,368 | 3,148,009,140 | | | | |
| | 3 | 2.5 | 13,734,807 | 3,342,125,356 | | | | |
| | 4 | 2.5 | 21,059,968 | 3,708,892,432 | | | 0 | |
| 1974 | 1 | 2.25 | 23,371,103 | 4,362,605,273[5] | | | | |
| | 2 | 3 | 24,203,495 | 4,032,502,219 | | | | |
| | 3 | 3 | 30,160,907 | 3,794,737,840[5] | | | | |
| | 4 | 3 | 28,694,456 | 4,285,404,033 | | | 0 | |
| 1975 | 1 | 2.25 | 32,404,699 | 4,368,838,751 | | | | |
| | 2 | 1.5 | 24,238,078 | 4,867,665,402 | | | | |
| | 3 | 2.25 | 18,203,735 | 3,658,754,181[5] | | | | |
| | 4 | 1.875 | 20,749,647 | 5,222,395,453 | | | 0 | |
| 1976 | 1 | 1.25 | 24,681,184 | 4,949,639,209 | | | | |
| | 2 | 1.5 | 15,383,100 | 5,111,606,409 | | | | |
| | 3 | 1.875 | 19,063,778 | 4,404,191,937[5] | | | | |
| | 4 | 1.5 | 20,757,462 | 4,922,875,309 | | | 0 | |
| | | | $397,666,152 | | | $ 7,568,948 | | $ 6,362,080 |
| % of Total Actual S/A Payments | | | | | | 1.90% | | 1.60% |



(See Footnotes on Attached Page)

Footnotes

(1) Cash paid based on interest billings presented during this quarter. These are based primarily on the previous quarter's average balance of eligible loans (those made after 8/1/69), but it includes to a small (but unknown) degree semi-annual and annual billings.

(2) Includes bills for the balances outstanding for the entire period 8/1/69 through 12/31/69.

(3) Because the reporting of interest paid is on a cash basis, the calculation of average balance of loans on which the special allowance was paid is based on the subsequent quarter's payment and the current quarter's rate.

(4) Average balance for the 153 days between 8/1 and 12/31/69, assuming a uniform increase in loans made during this period.

(5) Certain of these calculated average balances appear to be significantly out of line with the upward trend. The primary causes are probably delays in payment or in interest billing; for example, the low calculated balance for the third quarter of 1974, 1975, and 1976 might indicate some extra delays after the close of the fiscal year or perhaps just that few loans were made during the second quarter and repayments have reduced the balance. Regardless, it would not be proper to adjust these apparent anomalous balances; since then a valid comparison would not result between the actual special allowance payments and a hypothetical set of payments, assuming a different earnings floor or annual average. Note that none of these balances materially affects these hypothetical additional payment amounts.

(6) To be consistent with OE's cash basis reporting, these assumed additional payments are based on the prior quarter's rate and its average balance.

(7) The additional annual special allowance is assumed to apply to the average loan balances outstanding for each quarter for the year, to be paid in the first quarter of the subsequent year.

## APPENDIX E

## COMMITTEE ON THE PROCESS OF DETERMINING STUDENT LOAN SPECIAL ALLOWANCES

### STATEMENT OF EXPENSES

The following is a preliminary statement of the costs incurred during the preparation of the Report to Congress by the Committee on the Process of Determining Student Loan Special Allowances. These figures, provided by the Office of Education, are tentative but are generally representative of the overhead and contract expenses of the Committee. Funds expended were allocated to the budget of the Office of Guaranteed Student Loans, U. S. Office of Education.

### STATEMENT OF EXPENSES

| | |
|---|---|
| Committee Member Travel | $ 4,042,67 |
| Committee Member Per Diem | 1,775.58 |
| Committee Member Fees | 6,600.00 |
| Printing Costs (estimated) | 1,100.00 |
| Other | 566.30 |
| Subtotal | 14,084.55 |
| Contract Fees, Touche Ross & Co. | 50,000.00 |
| Total | $64,084.55 |

# REQUEST FOR PROPOSAL TO ASSESS COST TO LENDERS OF PROCESSING GUARANTEED STUDENT LOANS

TABLE OF CONTENTS

A. Introduction

B. Statement of Work

C. Performance Schedule

D. Evaluation Criteria

## A. INTRODUCTION

The Committee on the Process of Determining Student Loan Special Allowances was established by Congress in 1976 to examine ways to determine special allowances. The Committee is required to submit its recommendations to Congress in October 1977.

The Committee is currently studying a number of factors which influence the establishment of the special allowance rate. The costs to lenders of processing guaranteed student loans is one of the factors being studied. The purpose of the proposed project is to determine these costs.

### The Guaranteed Student Loan Program

The Guaranteed Student Loan Program (GSLP) enables students to borrow directly from qualified lending institutions to pay for the costs of attending eligible postsecondary educational institutions. The loans are made at the discretion of the lenders. Such loans are guaranteed by State or private nonprofit agencies or insured by the Federal government.

A student may apply for a loan if enrolled or accepted for enrollment on at least a half-time basis in an eligible educational instituiton. Ordinarily, a student may borrow up to $2,500 per academic year as an undergraduate or vocational student. A graduate or professional student may borrow up to $5,000 per academic year, although in some States the amount is less. The total amount a student may have outstanding while an undergraduate is $7,500. The aggregate limit for graduate or professional study, including loans made at the undergraduate level, is $25,000.

Most students are eligible for a Federal interest subsidy whereby the Federal government, rather than the student, pays the interest on the student's outstanding loan during the time the student is in school, during a "grace" period after the student has left the school, and during any authorized deferment of repayment period. The student borrower may take up to ten years to repay the loan. The amount of the payments depends upon the size of debts and the student's ability to pay. In most cases the student must pay at least $360 a year unless circumstances as agreed upon by the lending institution warrant a lesser amount.

### The Loan Process

A student borrower normally obtains a loan application from his local lending institution. After the student completes his part of the application, the school must complete a portion of this application certifying the student's enrollment, cost of education, academic standing and other financial aid awarded. In instances where the student's adjusted family income is $25,000 or over and he wishes to apply for Federal interest benefits, additional family financial information will be requested. The student presents the application to a participating eligible lender. If the lender agrees to make the loan, he first obtains the approval of the relevant guarantor, then disburses the loan to the student in one or more payments.

The Special Allowance Rate

Under the student loan program, the annual percentage rate charged to borrowers may not exceed 7%. To compensate lenders for earnings lost when the prevailing market interest rate is above that which students may be charged, the special allowance rate has been established. The special allowance rate, which is determined on a quarterly basis, is the incremental interest beyond 7% which is payable to the lender by the Federal government. The special allowance rate is determined by the Secretary of HEW after consultation with the Secretary of the Treasury Department. The special allowance rate may not exceed 3%.

## B. STATEMENT OF WORK

The contractor shall establish a data collection approach and then collect data to determine the costs to lenders of processing guaranteed student loans. The cost to lenders include all direct and indirect costs associated with the costs of funds, loan origination, loan servicing, and collections.

It is anticipated that the contractor will perform the following activities during the course of the engagement:

- Determine the factors affecting costs to lenders;
- Establish a data collection approach;
- Determine the institutions to be included in the study, subject to review and approval by the Committee;
- Develop a formal schedule for the conduct of field visits;
- Visit selected institutions to perform interviews with top management and loan personnel;
- Collect data on the costs to lenders of guaranteed student loans;
- Analyze the data collected;
- Prepare a draft final report summarizing findings;
- Present report to the Committee;
- Revise and finalize the report.

The final report should provide the Committee with all information required to understand the processing requirements and costs associated with the student loans. As such, the report should include:

- Schedules of student loan costs by type of lender;
- Costs associated with each major processing activity (or cost center) by type of lender;
- Identification of the reasons for variations in cost among types of lenders as well as various lenders of the same type.

## C. PERFORMANCE SCHEDULE

The following schedule is to be followed in conducting the proposed project.

| Milestone | Task Description | Completion Date |
|---|---|---|
| # 1 | Award of Contract | - - - - - |
| # 2 | Contractor presents proposed approach to the Committee | One week after contract award |
| # 3 | Select sites and schedule visits | One week after milestone # 2 |
| # 4 | Contractor staff training completed | One week after milestone # 3 |
| # 5 | Field work commences | Concurrently with milestone # 4 |
| # 6 | Field work completed | Six weeks after milestone # 4 |
| # 7 | Draft Report | Four weeks after milestone # 5 |
| # 8 | Final Report | Four weeks after milestone # 7 |

It is anticipated that a level of effort of approximately nine person months will be required to perform the proposed project.

## D. EVALUATION CRITERIA

Technical proposals received in response to this Request for Proposal will be evaluated according to the criteria shown below. Price will then be considered. Negotiations may be conducted with those offerors whose technical proposals are rated highest and whose price is in a competitive range.

The following criteria shall be used in evaluating technical proposals. The assigned points indicate the relative importance of each factor.

| Weighting (points) | Criteria |
|---|---|
| 25 | Offeror's familiarity with the requirements of the Guaranteed Student Loan Program and the characteristics of typical student loan processing, as demonstrated in a Statement of Understanding. |
| 30 | Offeror's proposed approach to providing service in accordance with the schedule required in the Statement of Work, including:<br>o Data collection approach;<br>o Site selection criteria;<br>o Awareness of potential problem areas and proposed solutions. |
| 25 | Familiarity of offeror's proposed project personnel with the Guaranteed Student Loan Program, its operations and costs. |
| 10 | Offeror's experience in conducting cost studies in other industries. |
| 10 | Offeror's experience with the banking and thrift institution industries. |
| 100 | |

# APPENDIX F

## STUDENT LOAN FLOW CHART

ORGANIZATION CHART

PAGE 1 OF 15

ORGANIZATION CPDSLA

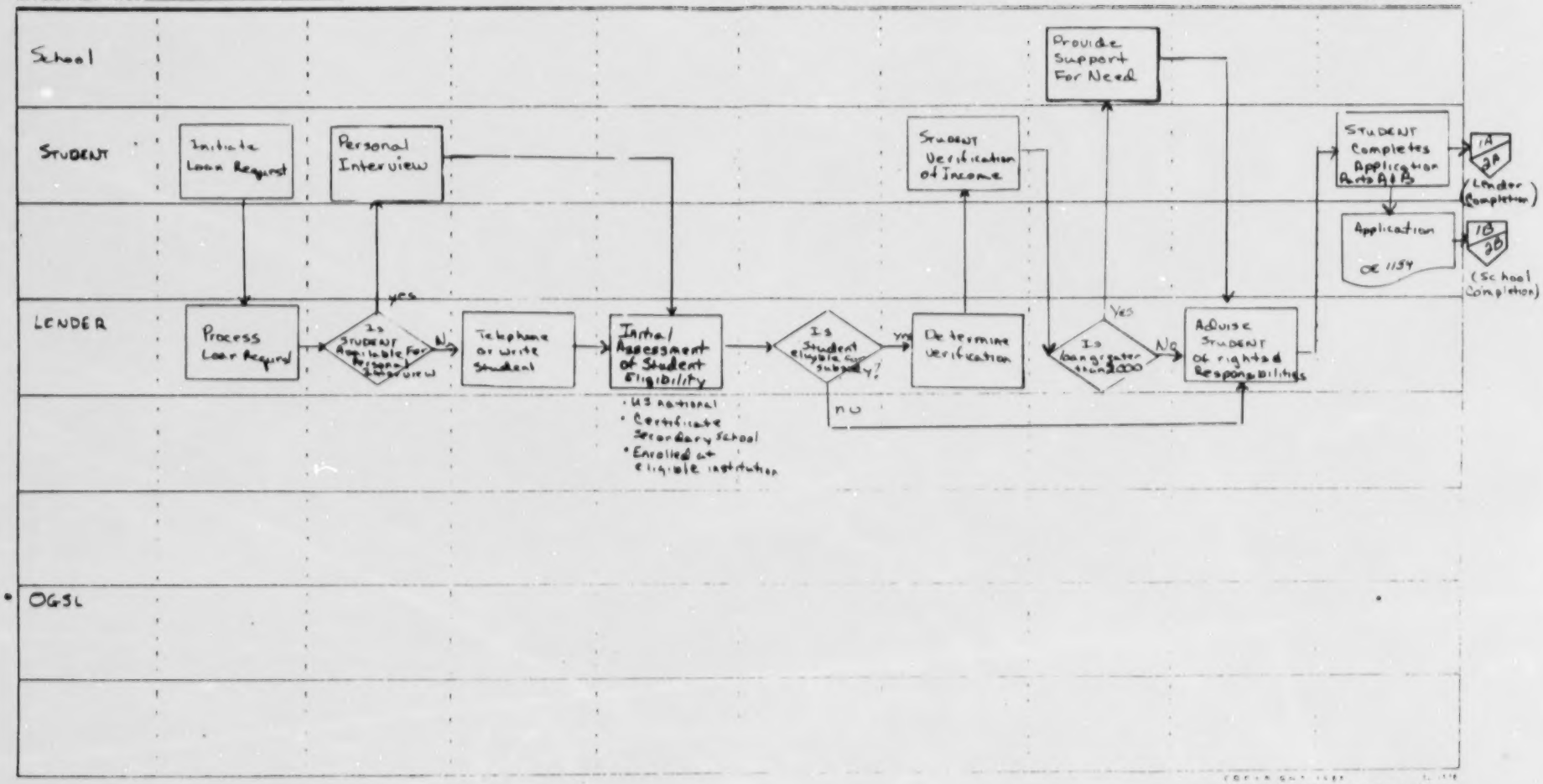
APPLICATION TITLE GSLP

LOAN ORIGINATION

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

PAGE 2 OF 15

ORGANIZATION CPDSLA

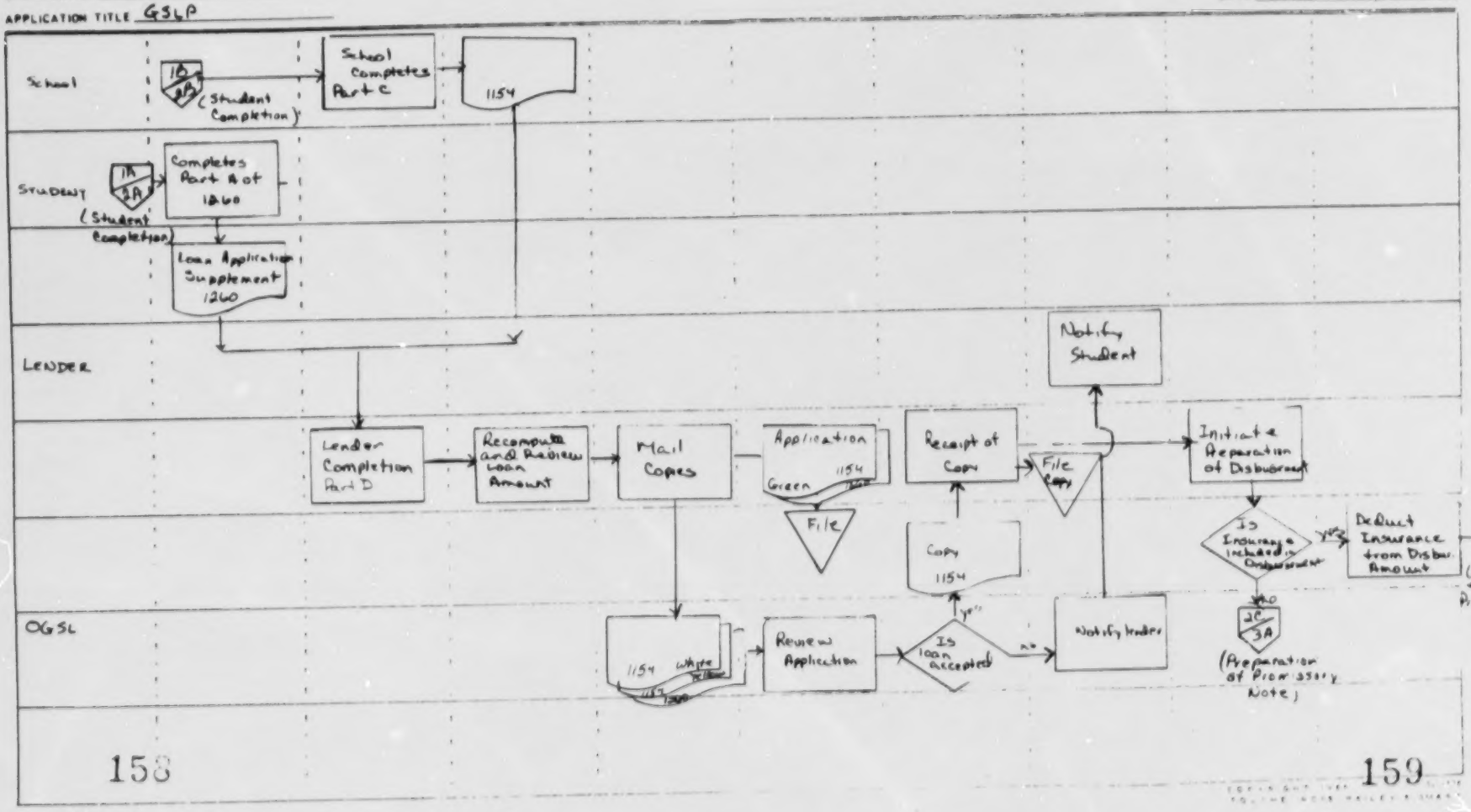
APPLICATION TITLE GSLP

# LOAN ORIGINATION

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

PAGE 3 OF 15

ORGANIZATION RPDSLA

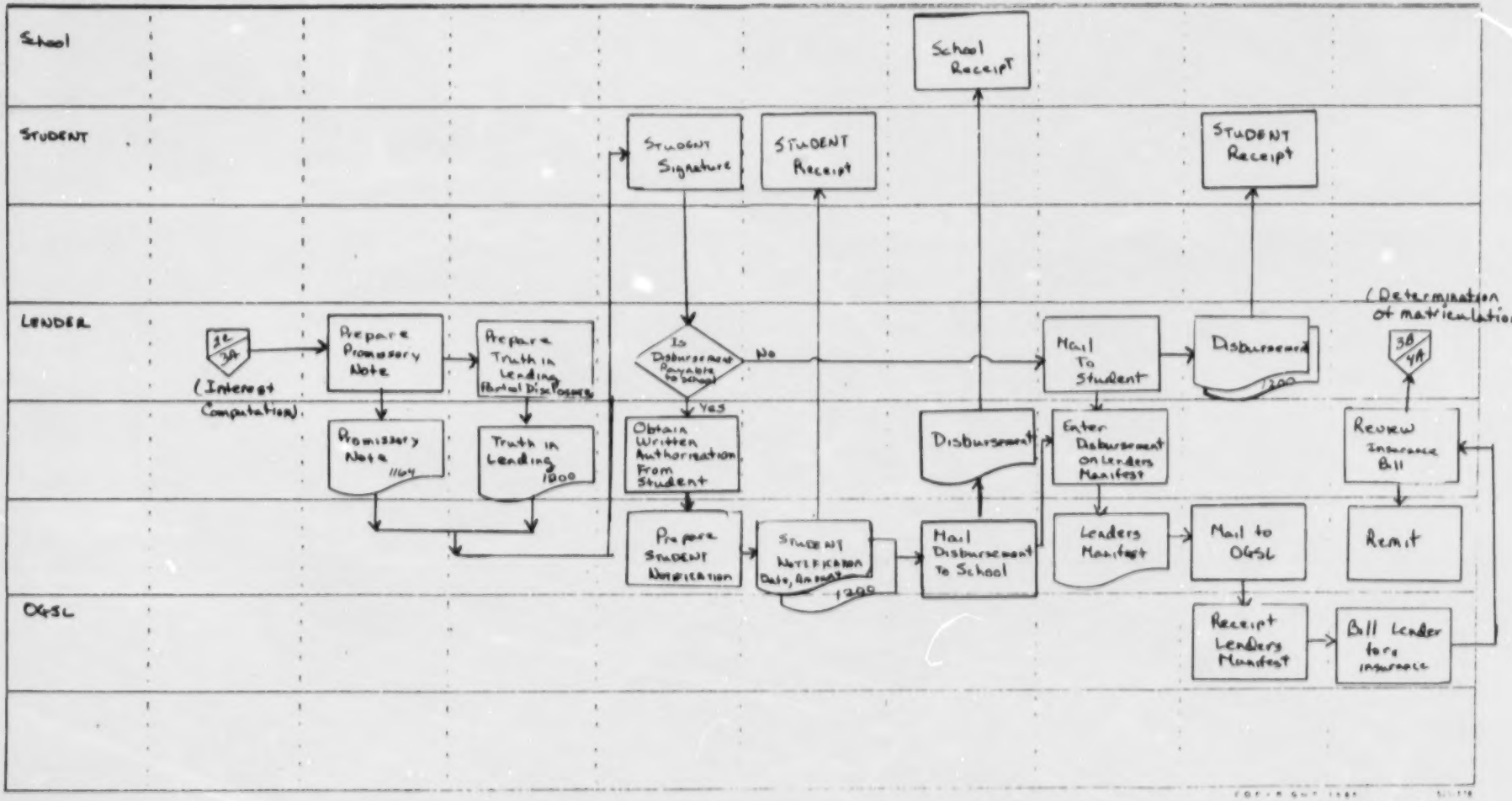
APPLICATION TITLE GSLP

LOAN ORIGINATION

APPLICATION NO

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

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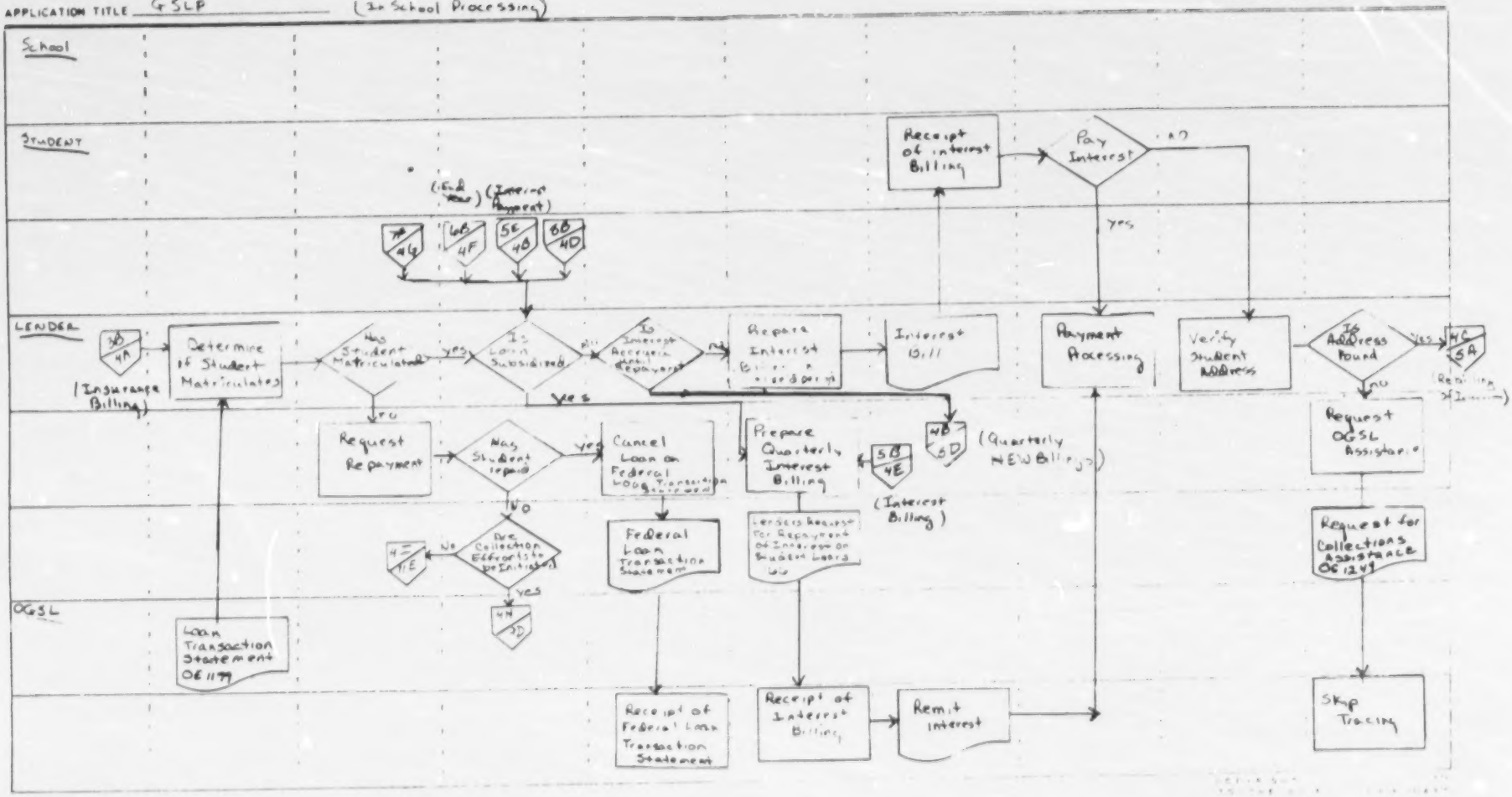
ORGANIZATION CPDSLA

APPLICATION TITLE GSLP Interim (In School Processing)

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

ORGANIZATION CPDSLA

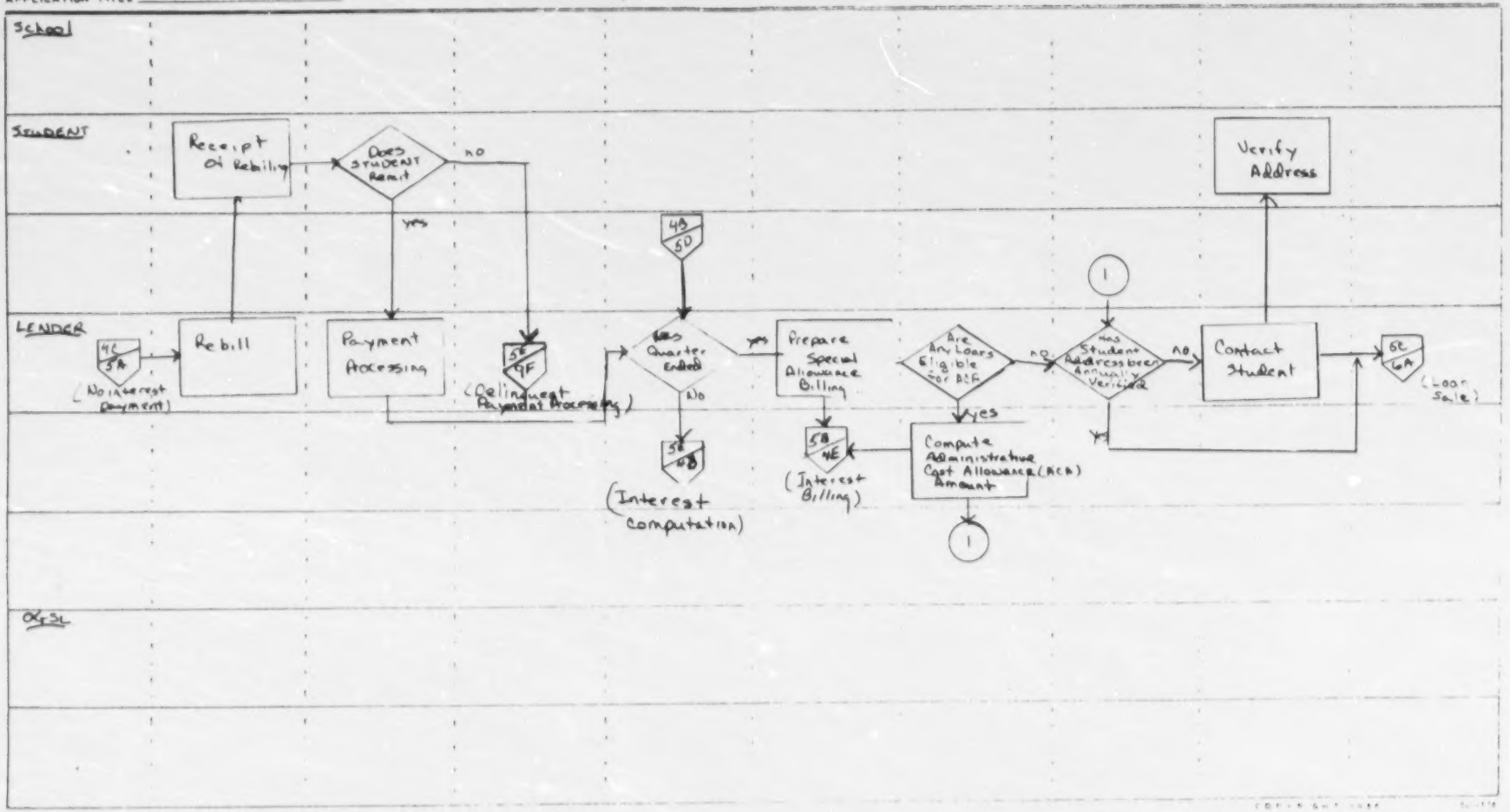
APPLICATION TITLE GSLP

Interim
(In School Processing)

APPLICATION NO 5 15

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

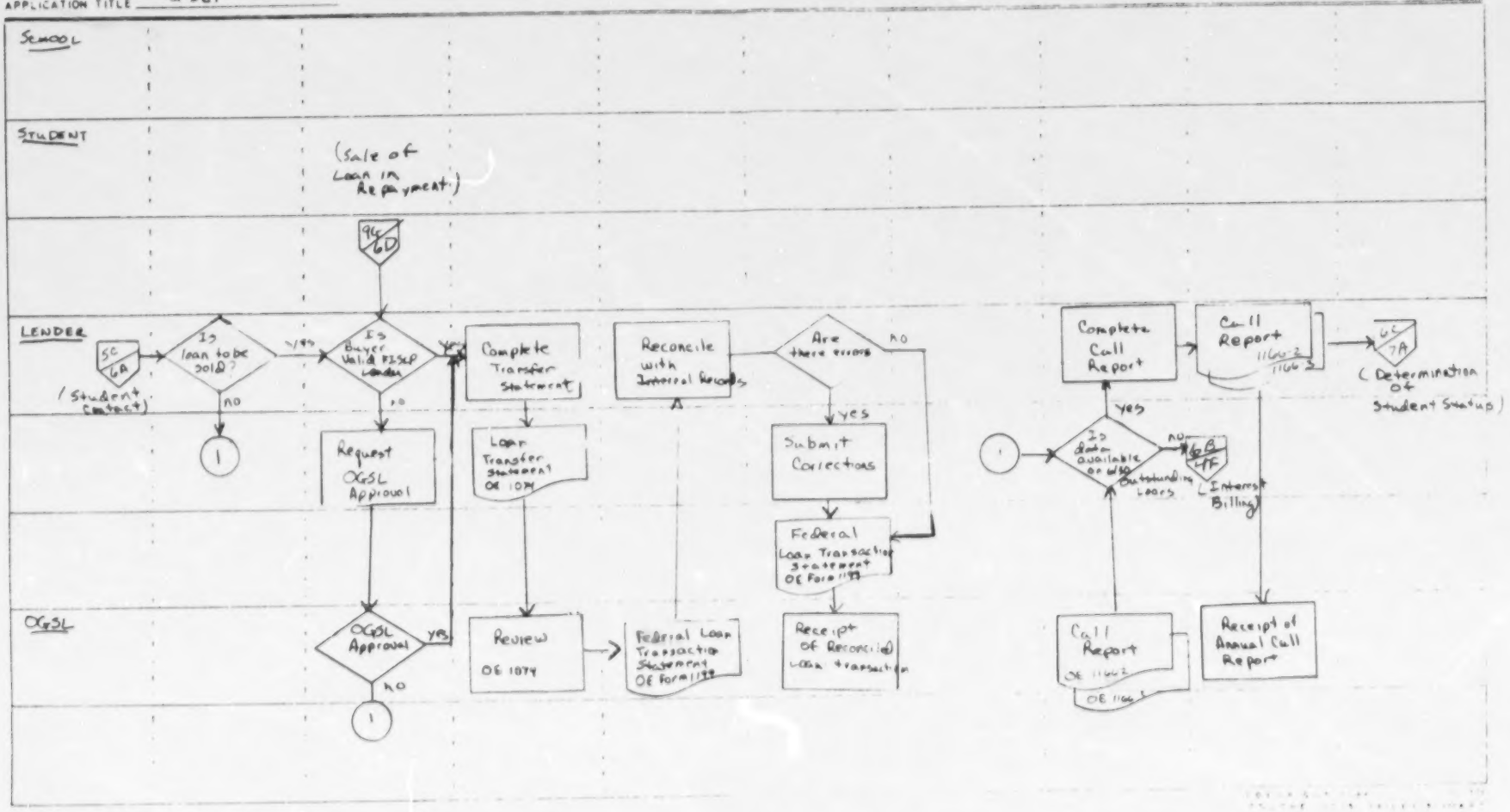
ORGANIZATION: PHEAA / GSLP

APPLICATION TITLE: Interim (In-School Servicing – Special Processes)

APPLICATION NO: 6 15

PREPARED BY: DB

DATE: 5/4/77



ORGANIZATION CHART

ORGANIZATION CPDSLA

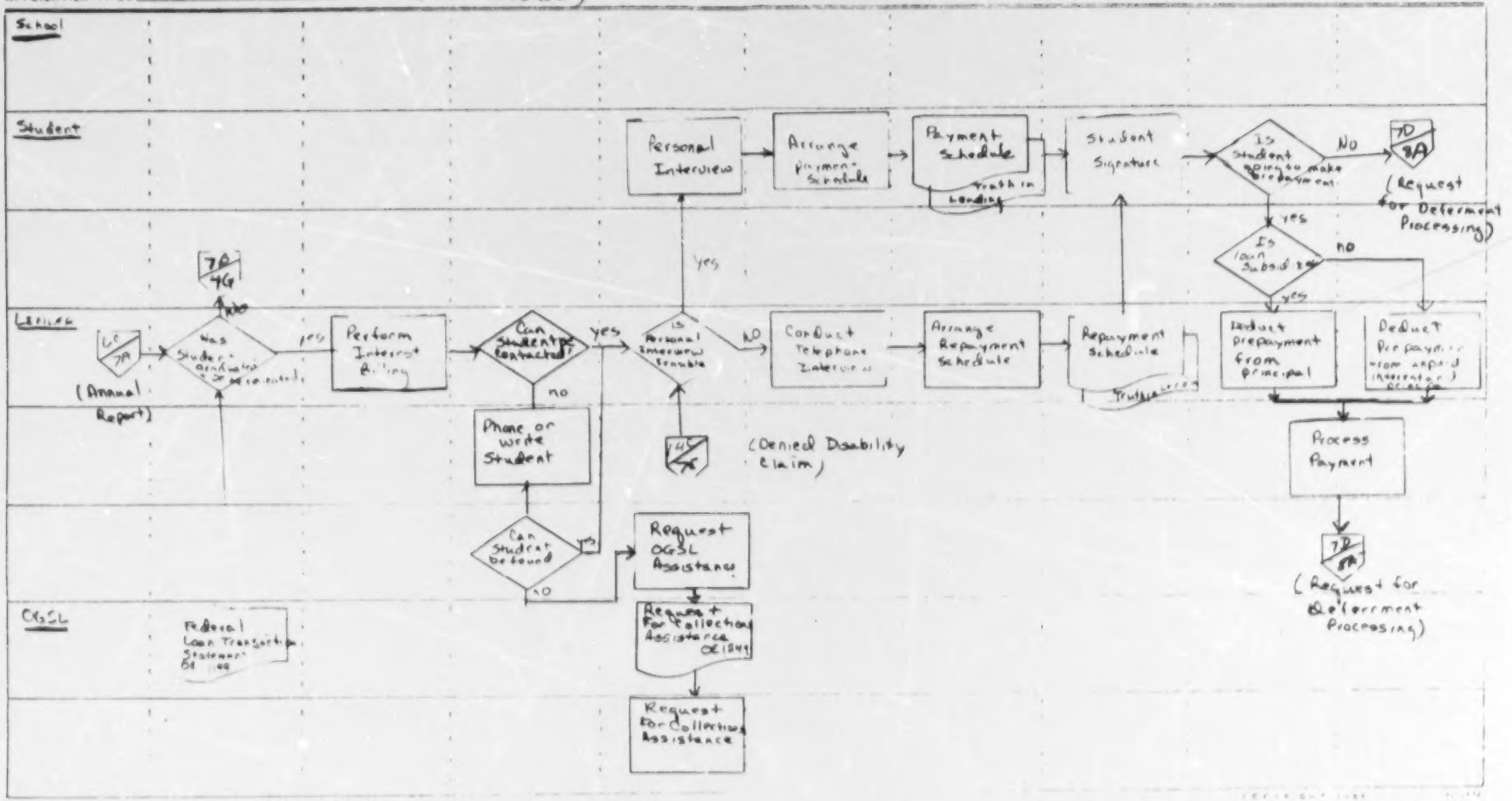
APPLICATION TITLE GSLP

Interim
(Grace Period)

APPLICATION NO 7 ... 15

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

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ORGANIZATION CPDSLA

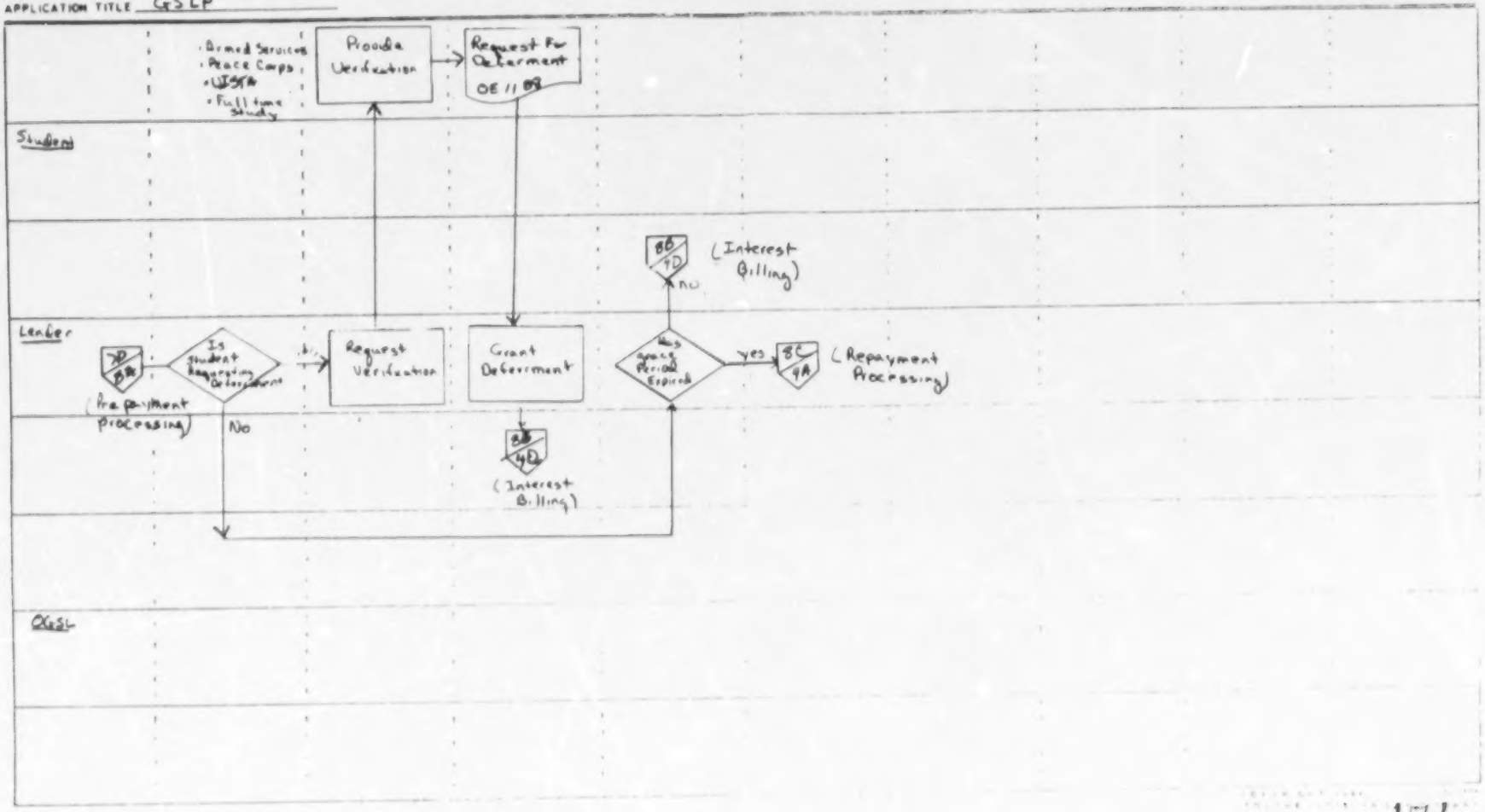
APPLICATION TITLE GSLP

Interim
(Grace Period)

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

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ORGANIZATION CPDSLA

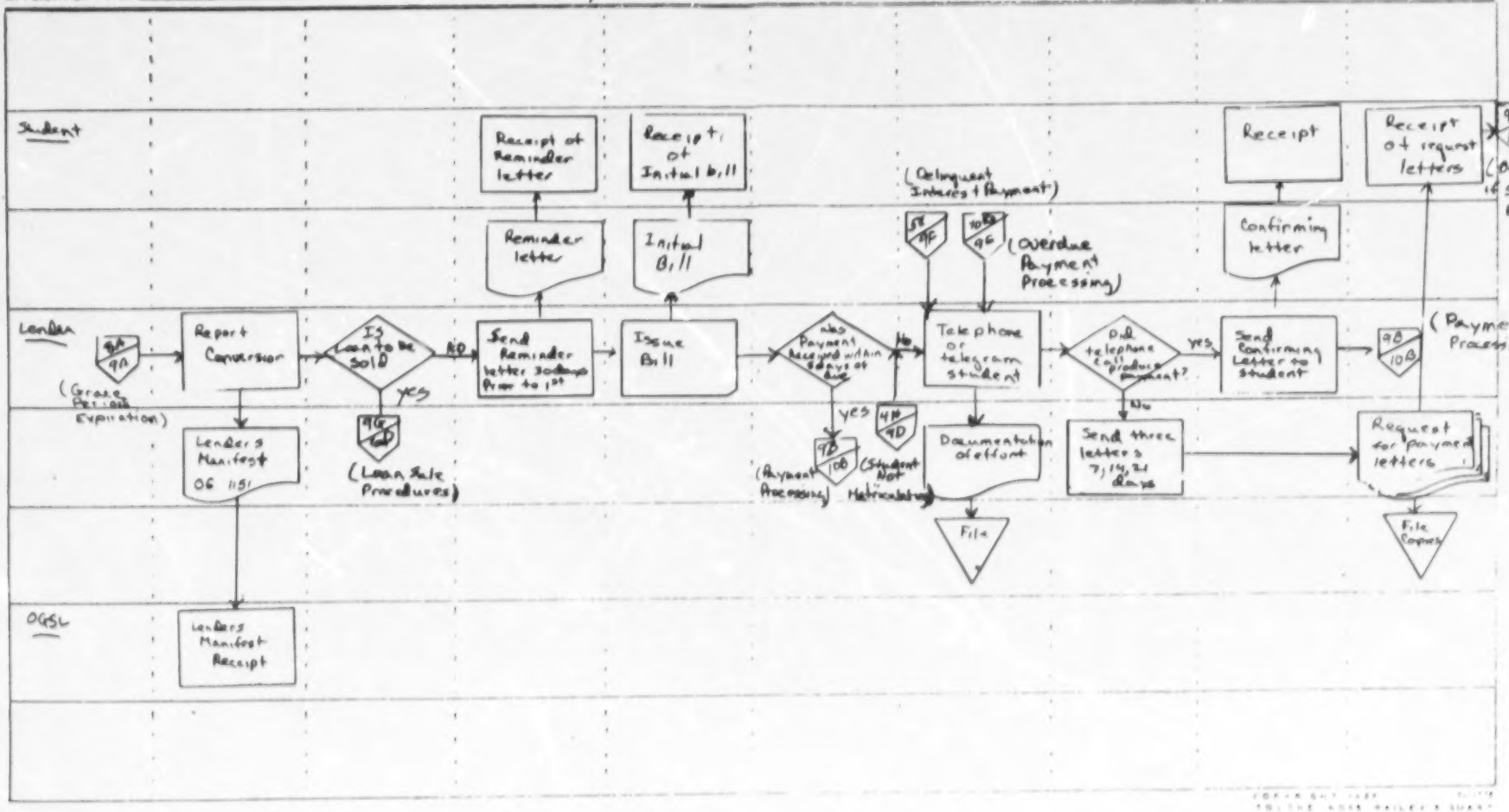
APPLICATION TITLE GSLP

Payment Processing (Delinquent Payment)

APPLICATION NO

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

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ORGANIZATION CPDSLP

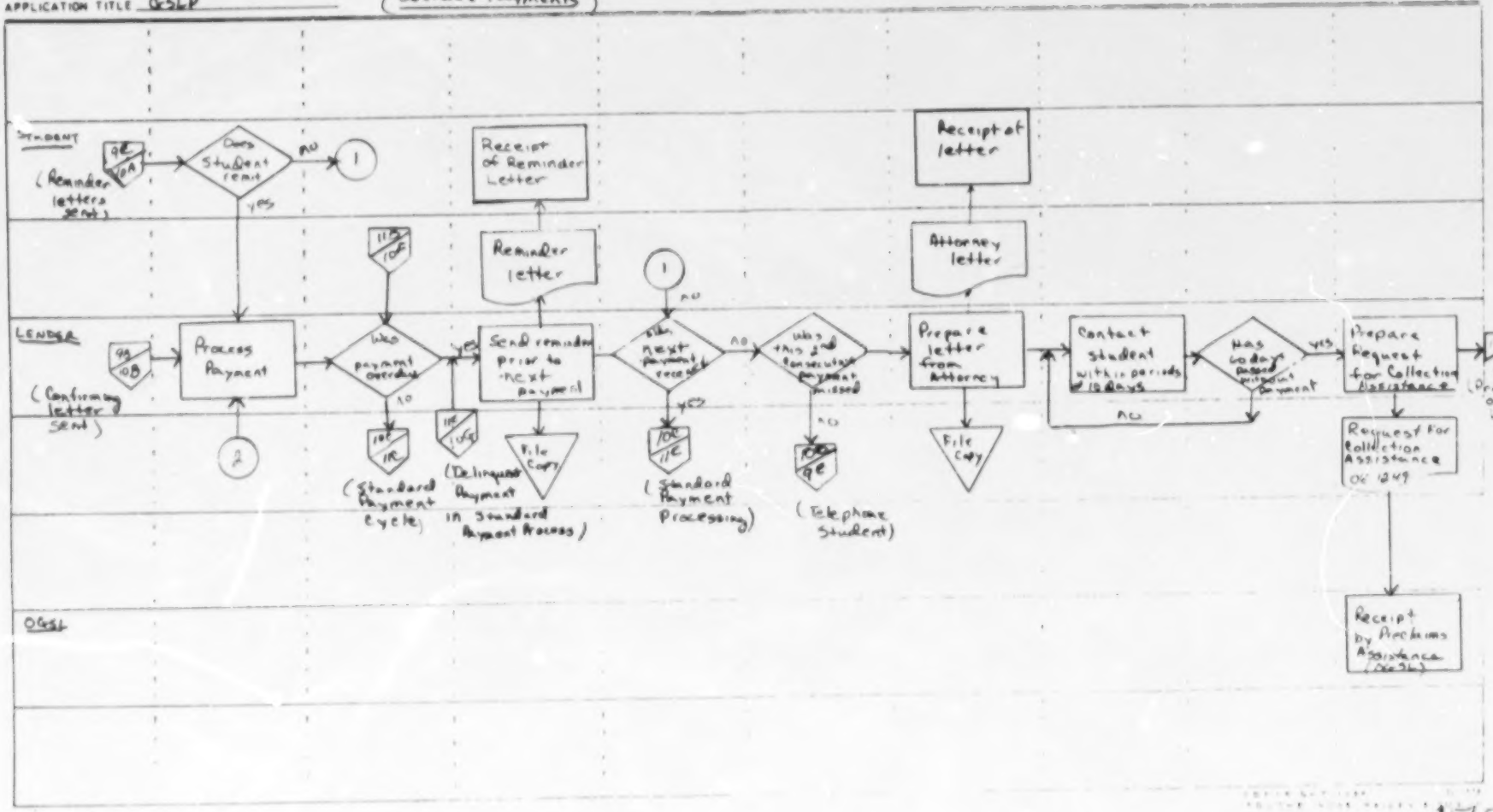
APPLICATION TITLE OSLP

Payment Processing
(Overdue Payments)

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

ORGANIZATION CPDSL17

APPLICATION TITLE GSLP

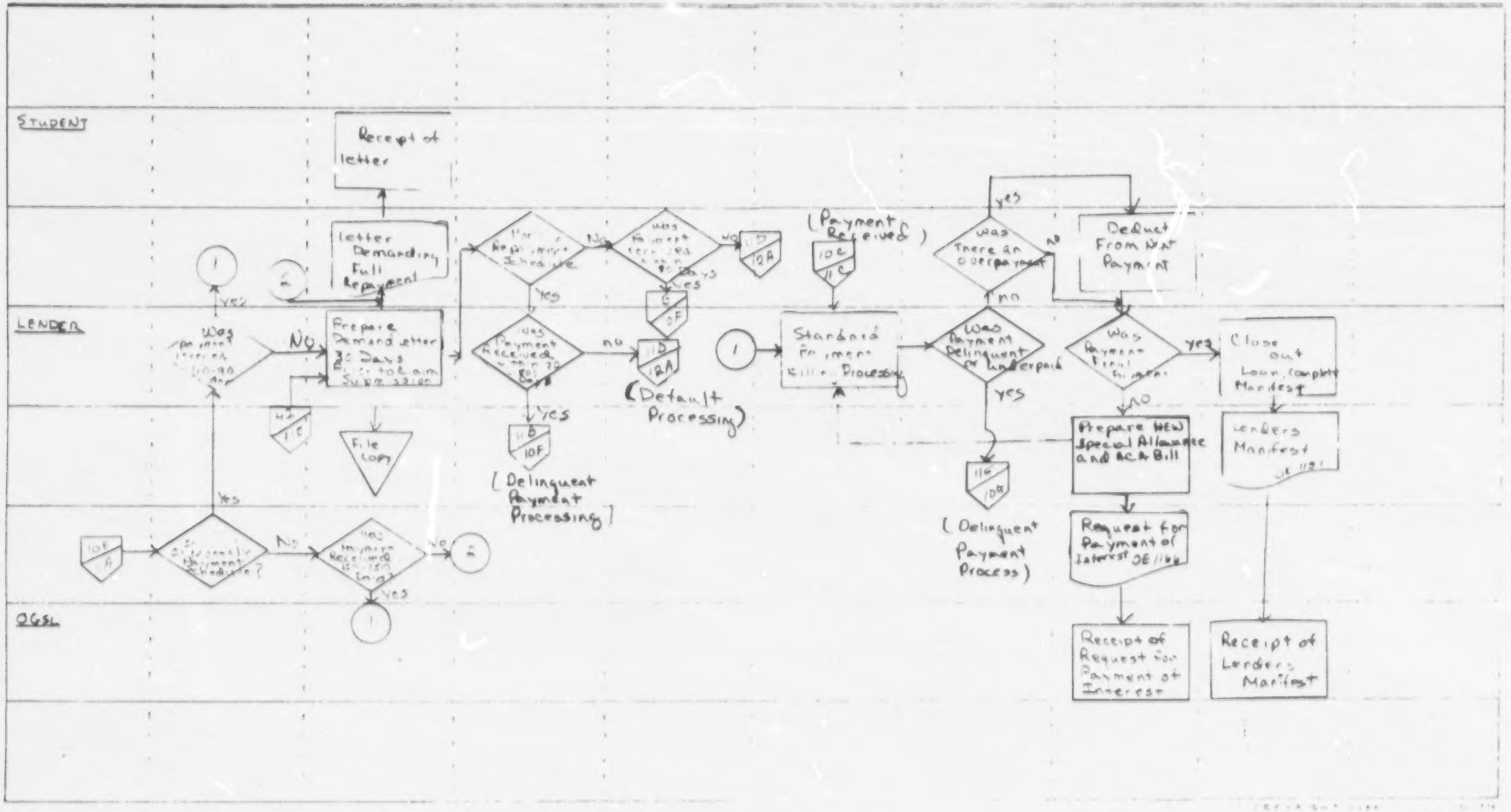
Payment Processing

(Delinquency Processing, Standard Payment Processing)

APPLICATION NO

PREPARED BY DB

DATE 5/4/77



ORGANIZATION CHART

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ORGANIZATION CPDSLA

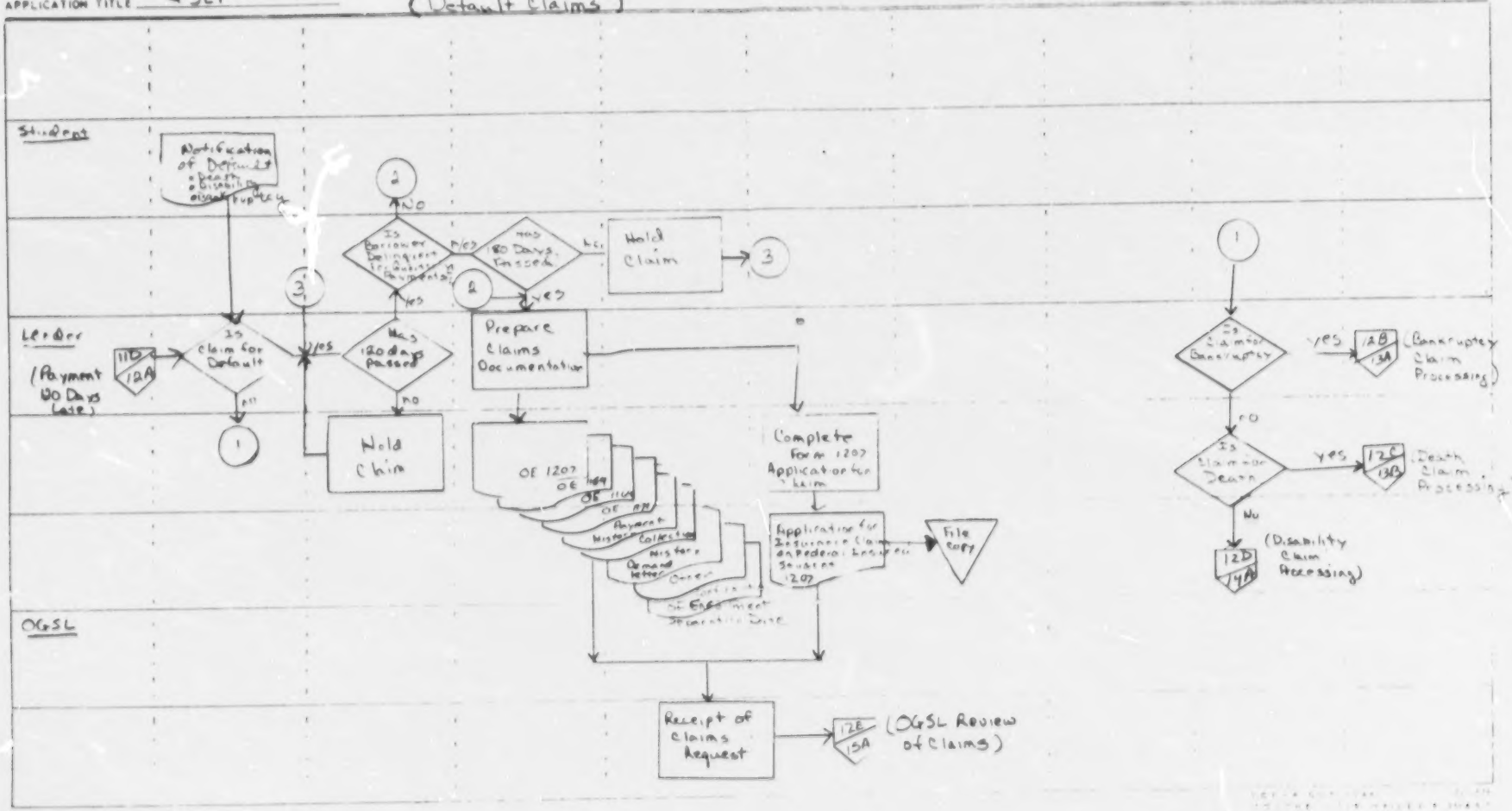
APPLICATION TITLE GSLP

APPLICATION NO.

PREPARED BY DB

DATE 5/4/77

Claims Processing (Default Claims)



ORGANIZATION CHART

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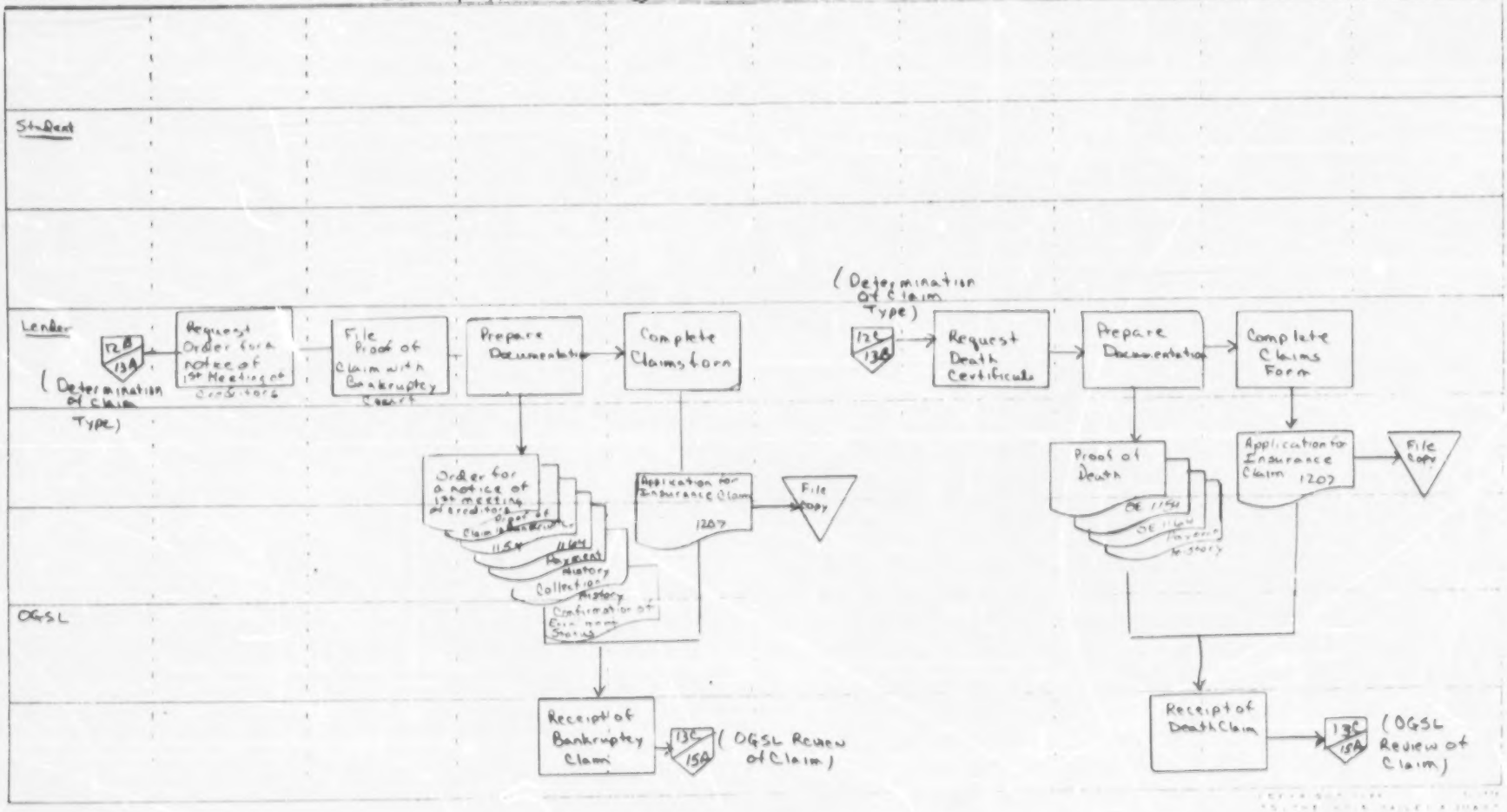
ORGANIZATION CPDSLA

APPLICATION TITLE GSLP — Claims Processing (Bankruptcy/Death Claims)

APPLICATION NO.

PREPARED BY D.B

DATE 5/4/77



ORGANIZATION CHART

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ORGANIZATION CPDSLA

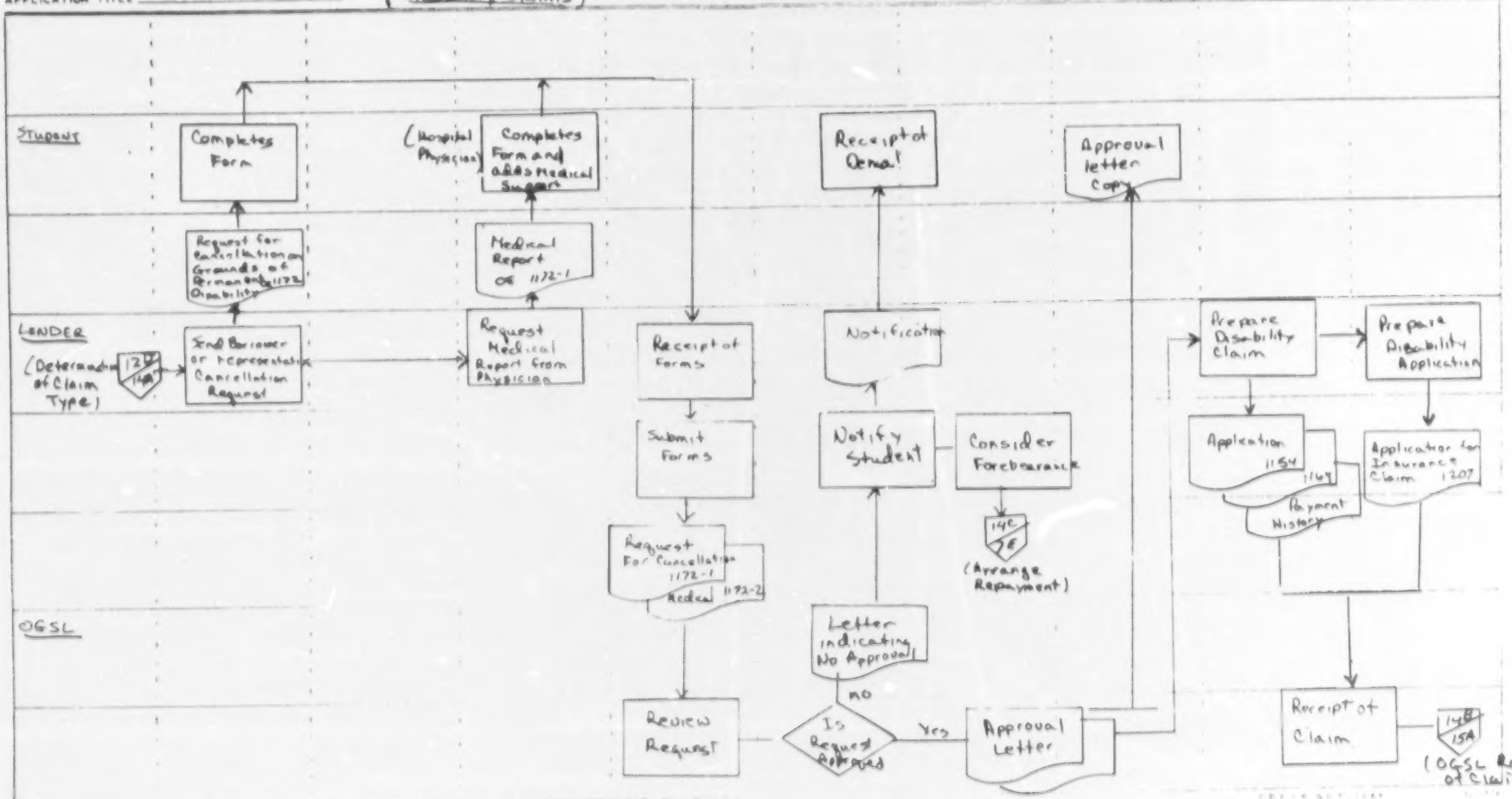
APPLICATION TITLE GSLP

Claims Processing (Disability Claims)

APPLICATION NO

PREPARED BY DB

DATE 5/4/77

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ORGANIZATION CHART

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ORGANIZATION CDDSLA

APPLICATION TITLE GSLP (Claims Processing (OGSL Claims Payment))

APPLICATION NO

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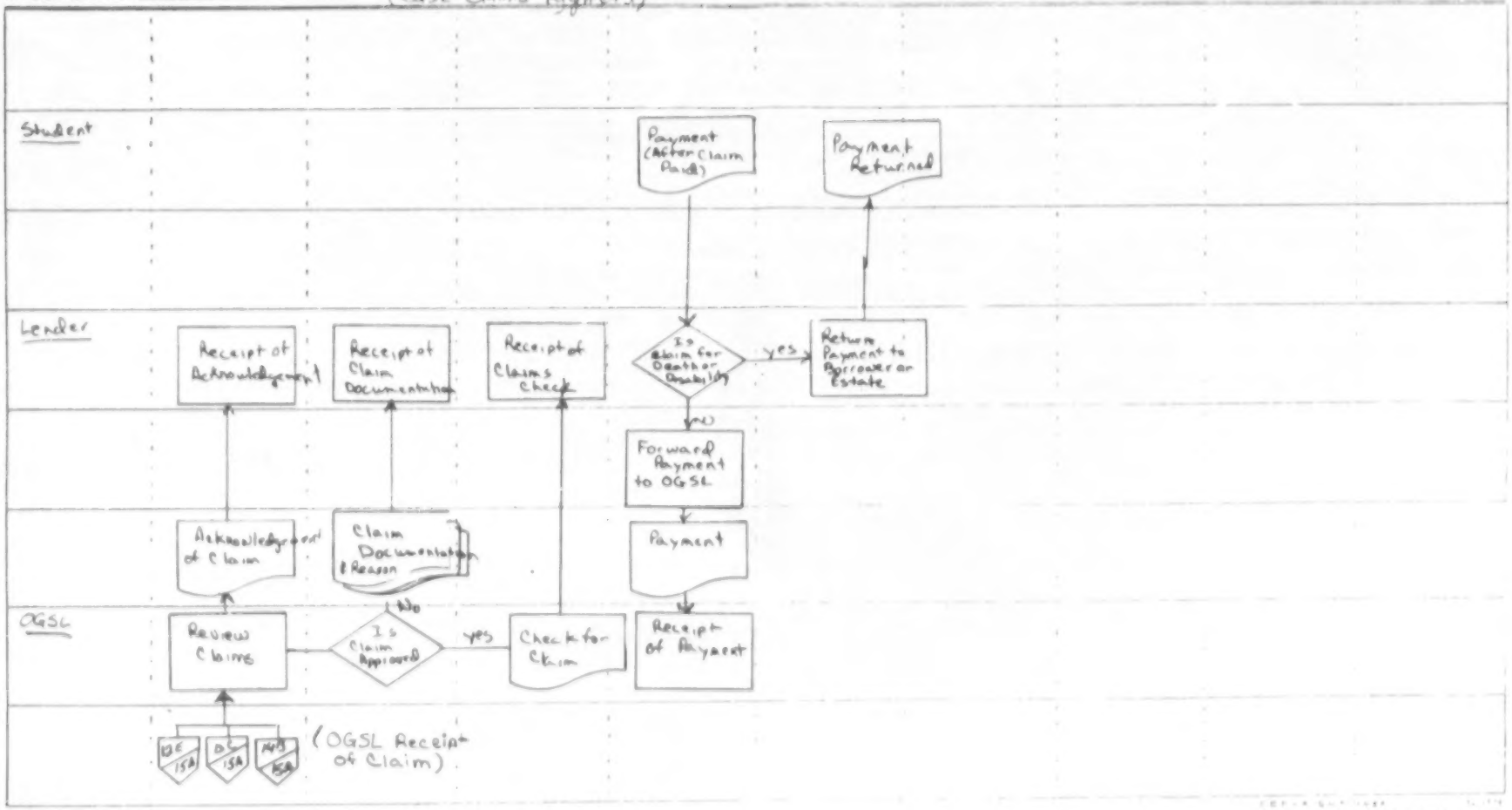
DATE 5/4/77